



# It's Not Just the Weather

The man-made crises roiling property insurance markets

August 2022



## **EXECUTIVE SUMMARY**

Weather-related disasters are becoming increasingly common—and costly. Disaster claim payouts by insurers now approach \$50 billion per year, on average, up some 25 percent from a decade ago, adjusted for inflation. Climate change, rapid population growth in disaster-prone states and, more recently, inflation all play important roles in driving the cost of insuring natural disasters upward. Yet managing these risks is precisely what insurers are equipped to do, while bringing relief and protection to the millions of home and business owners impacted by these tragic events each and every year. At the same time, property insurance markets in many states are showing signs of stress. Indeed, several markets are in a state of crisis, with a number of insurers recently becoming insolvent. In this paper, we analyze the origins, root causes and consequences of increasing stress and instability in property insurance markets, using several of the most severely impacted states as case studies. The paper concludes with recommendations designed to relieve pressure and restore stability in those markets.

The principal conclusion of our analysis is that crises in property insurance markets today frequently have little to do with Mother Nature. Instead, man-made crises in the form of legal system abuse, claims fraud, and regulatory interference are the root causes of most market instability. As is documented in this paper, each of these problems increases system costs, which in turn has led directly to higher premiums for policyholders. Market instability also increases uncertainty, forcing individual insurers to restrict coverage, cancel or non-renew policies and exit markets.

Just as with natural disasters, the cost of these man-made crises is measured in billions of dollars. But unlike perils such as hurricanes, wildfires, and tornados—which can be readily modeled and priced by insurers—legal system abuses, fraud, and misguided regulation cannot. These unmodeled and largely uncontained risks are in some cases solvency-threatening, obligating insurers to take drastic steps to protect and conserve capital, with predictably adverse consequences on price, coverage availability, and competition.

Fixing the nation's imperiled property insurance markets is an insurance industry priority. But insurers cannot restore these markets to health alone. To do so requires a focused and enduring commitment by state legislators and regulators to adopt meaningful legal system reforms, attack fraud at its source, and promote regulatory stability. To facilitate that objective, this paper concludes with a series of concrete recommendations for addressing each of these root causes of instability. Collectively, these recommendations form an action plan that, if adopted, can help restore stability to property insurance markets in the nation's most disaster-prone states.

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## INTRODUCTION

We hear a lot about severe weather events these days—epic droughts and wildfires in the West, catastrophic hurricanes in the Southeast and Gulf states, powerful tornados in the Midwest and Plains and 100-year floods recurring every few years just about everywhere. These events are tragic, taking hundreds of lives each year. They are also costly, annually resulting in tens of billions of dollars in property damage and lost business income. Over the past decade (2012-2021), average annual insured catastrophe losses totaled \$47 billion, up from \$16 billion per year in the 1990s.



Much of this increase can be attributed to rapid population growth in catastrophe-prone areas such as the Atlantic and Gulf of Mexico regions<sup>1</sup>—those most vulnerable to hurricanes—where the population increased from 51.9 million in 2000 to 60.2 million in 2017 (8.3 million, or 16.0 percent). Other causes for the increase in catastrophe losses include inflation, which has reached a 40-year high, and damage from more severe weather. But the tripling of rebuilding and repair costs since the 1990s (a nearly 10-fold increase since the 1980s) well exceeds the impacts of demographics, economics, and even climate. Indeed, a closer examination of cost drivers in many catastrophe-prone states over the past 30 years reveals that man-made disasters, originating in a state's legal system and regulatory environment, are a root cause of periodic crises that lead to large scale insurance market disruptions. Invariably, these crises increase costs and reduce insurance availability.

History is once again repeating itself. Having failed to learn from their past mistakes, several catastrophe-prone states today face crises of their own making. States such as Florida, Louisiana, and California are experiencing an accelerating number of insurance policy non-renewals, tighter underwriting restrictions, insurer ratings downgrades, market exits, and insolvencies. The consequences, as in past crises, are largely borne by policyholders who face higher prices and fewer options when shopping for insurance.

If history is any guide, the man-made damage to insurance markets in these states will have to reach catastrophic proportions before policymakers enact the necessary reforms. Florida, for example, in the wake of record hurricane losses in 2004 and 2005, rather than seeking solutions that would bring new insurance capacity to the state, decided to freeze private insurer rate increases in 2007 and go back to the 2006 rates for Florida Citizens, the state-run insurer of last resort (and freeze rates at those levels for two years). These actions created a direct risk to insurer solvency, leading many to significantly scale back their operations in the state. Over a million policyholders were forced to purchase coverage through Citizens.<sup>2</sup> Although enacted reforms eventually restored a measure of stability, Florida's homeowners insurance market today is once again in full meltdown, suffering under the crushing burden of more than \$3 billion in litigation costs in 2021—a doubling since 2016. Last year, Florida had the dubious distinction of accounting for 76 percent of all homeowners insurance claims litigation in the United States, despite accounting for just 7 percent of claims.<sup>3</sup> Under siege from litigation run amok, insurers have again pulled back, with hundreds of thousands of policyholders scrambling for coverage from the state-run insurer.

Florida is hardly alone in implementing legislation and/or regulation that hinders, rather than helps to ensure, the availability and affordability of essential coverages. In California, since 1985 insurers have been required to offer earthquake insurance to homeowners, even if the home sits atop an active fault. Yet according to FEMA, only 10 percent of the state's residents have earthquake coverage,<sup>4</sup> suggesting the mandate has been ineffective. Fast forward to 2022, California is once again seeking to enforce mandates—including moratoria

1 <https://www.census.gov/content/dam/Census/library/visualizations/2019/demo/coastline-america-print.pdf>.

2 Florida Property Insurance Corporation: <https://www.citizensfla.com/policies-in-force>.

3 Florida Office of Insurance Regulation, Property Insurance Stability Report, July 1, 2022, at [https://foir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2022-isu-report.pdf?sfvrsn=34f77ed6\\_2](https://foir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2022-isu-report.pdf?sfvrsn=34f77ed6_2).

4 FEMA, Earthquake Insurance, accessed at: <https://www.fema.gov/emergency-managers/risk-management/earthquake/insurance>.

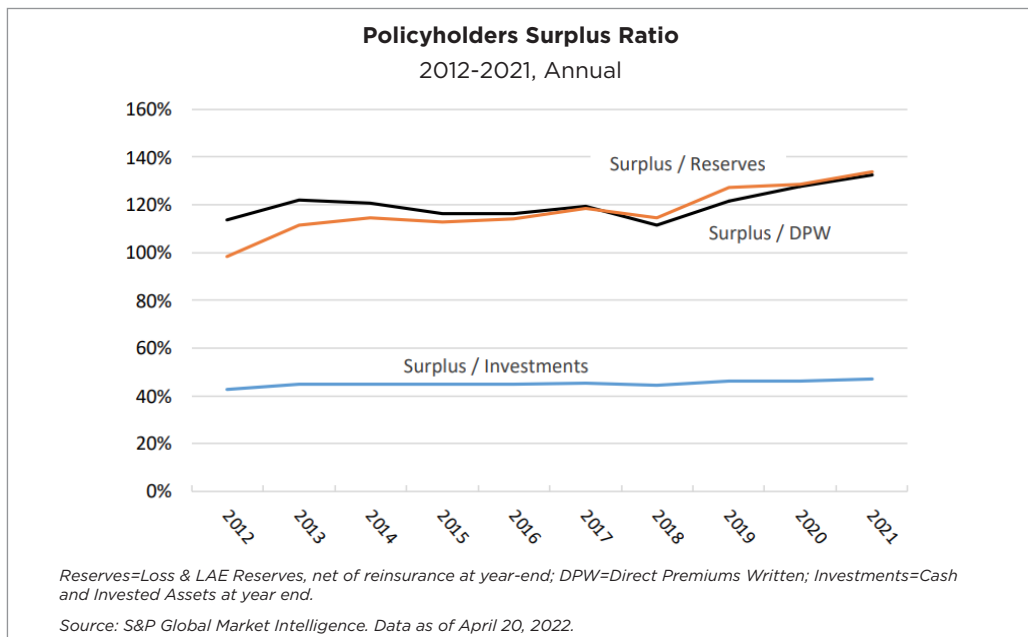
on non-renewals and expanded FAIR plan coverage—to address reduced market capacity due to increasing wildfire losses. Such efforts do nothing to reduce risk and actually may deter insurer participation in the market.

Louisiana is another state with a long history of mega disasters. Yet when Hurricane Katrina struck the state in 2005—a storm that to this day remains the costliest natural disaster in United States history—the state quickly recognized the threat to its insurance markets. Unlike Florida, Louisiana took steps that incentivized insurers to remain and even expand their presence, all while securing private reinsurance to strengthen the state’s exposure to future storms.<sup>5</sup> It is paradoxical that in the wake of Hurricane Ida — which made landfall in Louisiana in August 2021 and became the second costliest hurricane ever to strike the United States — the state seems to have forgotten the lessons that it learned in the aftermath of Katrina, opting instead for a heavy-handed regulatory approach. New regulations resulted in a more expensive and adversarial claims process while simultaneously directing insurers to pay for certain types of loss not covered under the terms of the policy.

The current insurance crises in Florida, California, and Louisiana have a common denominator—each was manufactured by the state itself through a combination of misguided regulation and a legal environment that encourages excessive litigation. As history has demonstrated, the consequences of failing to adequately address these crises could manifest in the form of reduced availability and affordability of insurance for tens of millions of home and business owners. This analysis will examine the underlying issues affecting distressed property insurance markets in the U.S. today—causes which are largely man-made and must be fixed to restore market health and stability for consumers.

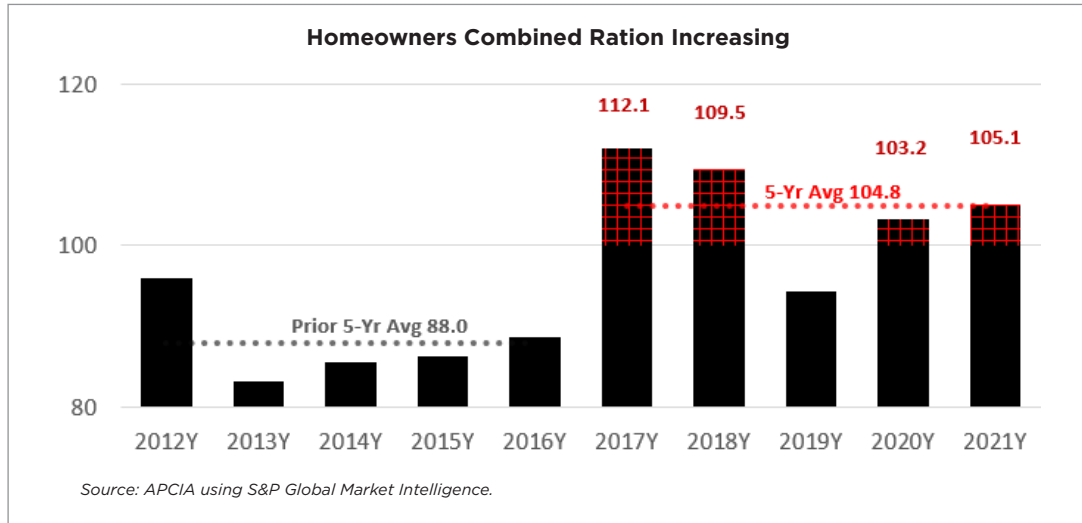
## THE GROWING PROPERTY INSURANCE CRISIS

Insurers continue to face increased exposures across property and casualty lines due to issues such as climate change, growing cyber risks, and more communities built in disaster-prone regions. However, even as the effects of climate change intensify, insurers do not view increasing weather-related exposures as unmanageable. Insurers confront climate change in the normal course of their business and are well-equipped to not only understand and measure weather and climate-related risk, but also to reprice these risks annually. As a result, the industry has been successful in maintaining adequate capital and surplus levels to cover the growth in exposures, as shown in the chart below, which demonstrates that policyholder surplus ratios have remained relatively stable over the last decade.



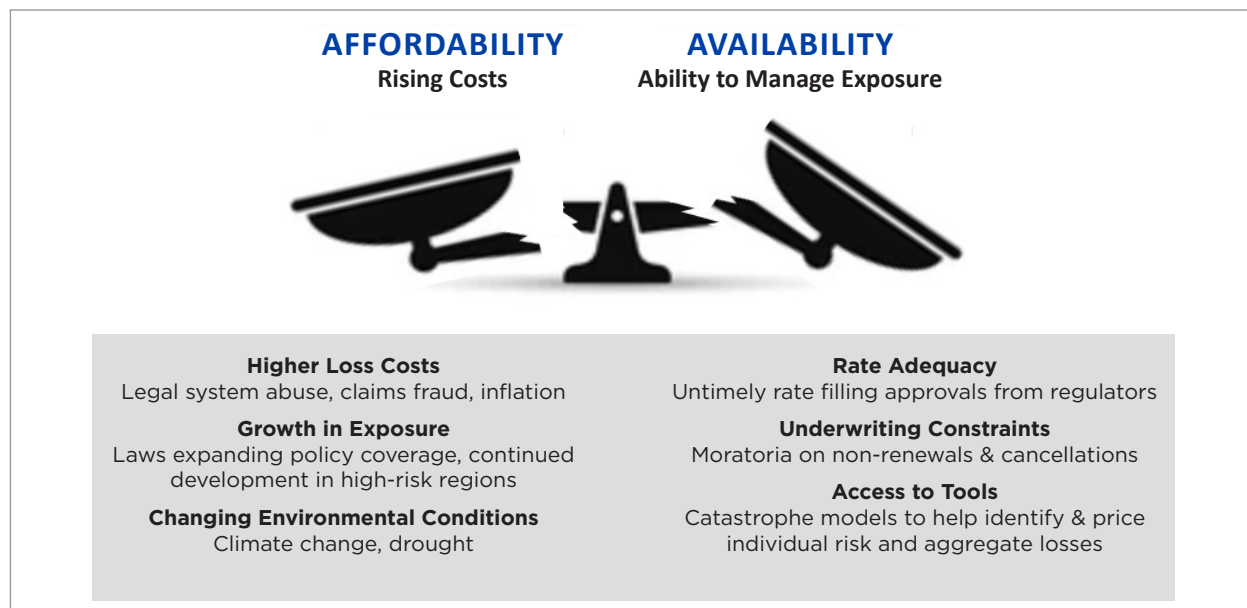
5 Louisiana Insurance Market Bills Passed in 2007. <https://www.insurancejournal.com/magazines/closingquote/2007/08/06/82761.htm>.

However, while policyholder surplus ratios appear stable for the broader industry, property insurers have experienced significant underwriting losses in the homeowners line in four of the last five years. The average combined ratio for the most recent five years (2017-2021) climbed to 104.8, versus 88.0 for the prior five years (2012-2016). In these years when the combined ratio exceeded 100 percent, insurers paid out more money to cover losses and expenses than they were able to collect in premiums.



While catastrophe-exposed states are experiencing increasing losses due to changing environmental conditions and immediate threats, such as climate change and drought, property insurance markets in a growing number of these states are facing challenges increasingly due to causes unrelated to weather. The real underlying causes that have led to insurance market crises in multiple states are varying combinations of higher loss costs driven heavily by legal system abuse, claims fraud, government interference in the form of both new laws that expand policy coverage and overall exposure for insurers, and regulatory constraints that simultaneously limit the ability of insurers to manage growing exposure and costs.

Insurance markets must strike a delicate balance between both affordability and availability. This requires insurers having the flexibility to manage exposure as costs increase. In markets that have experienced this dual challenge of significant loss cost increases and regulatory constraints that limit insurers' ability to quickly respond, markets have not only been thrown out of balance, but we are increasingly seeing them buckle.



The weight and pressure from these additional man-made issues have created highly volatile market conditions in some states. The ongoing uncertainty and pressure have led to significant market disruption, driven by a growing number of insurer insolvencies while other insurers have opted to pull back from the most volatile markets, resulting in widespread non-renewals and cancellations until market conditions stabilize.

## LEGAL SYSTEM ABUSE

Insurers are facing increasing legal system abuse across the country as litigious environments combine with rampant lawsuit inflation to create a windfall for bad actors looking to capitalize on insurance claims. Legal system abuse is particularly pronounced in catastrophe-prone states, as opportunists target families and businesses overwhelmed in the aftermath of disasters, while insurers work to adjust and settle a significant influx of claims.

## LAWSUIT INFLATION

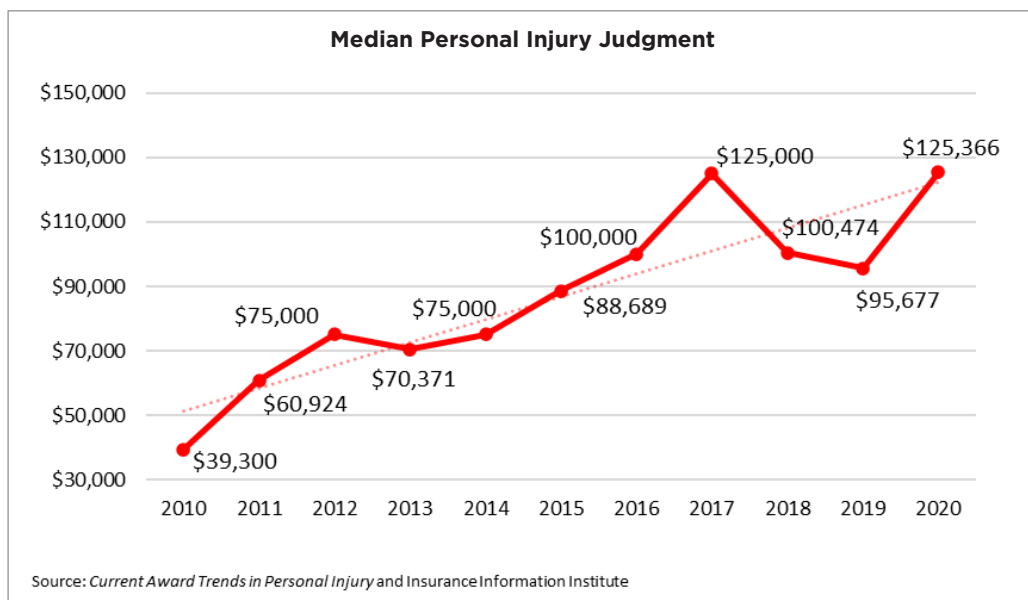
Across most lines of insurance insurers are seeing an outsized growth in lawsuit verdicts and in turn ultimate claims settlement costs, resulting from legal system abuses that are distorting what is considered appropriate compensation and how to obtain it.

By almost any measure, litigation-involved recoveries are now increasing at previously unseen rates. This includes, for example, increases in average verdicts, median verdicts for single fatalities, nuclear verdicts which include exceptionally high jury awards, billion-dollar personal injury verdicts, and verdicts involving trucking or workplace class actions. As individual verdicts reach new heights, they establish new precedent—thus creating a positive feedback loop influencing future judgments for liability cases, ultimately fueling lawsuit inflation across all lines of business.

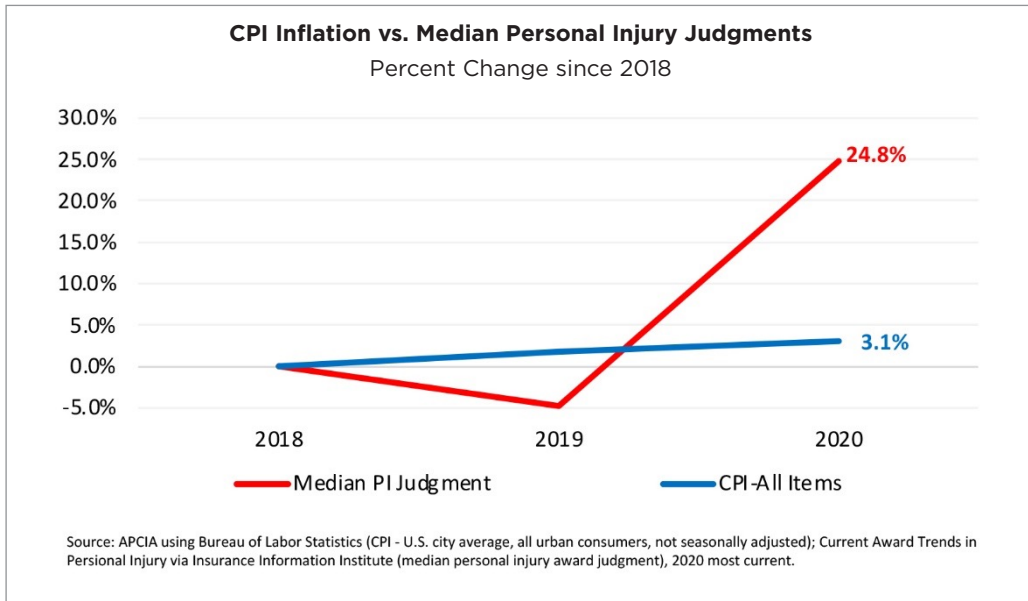
The following examples highlight the recent effects of lawsuit inflation.

### *Average and Median Verdicts*

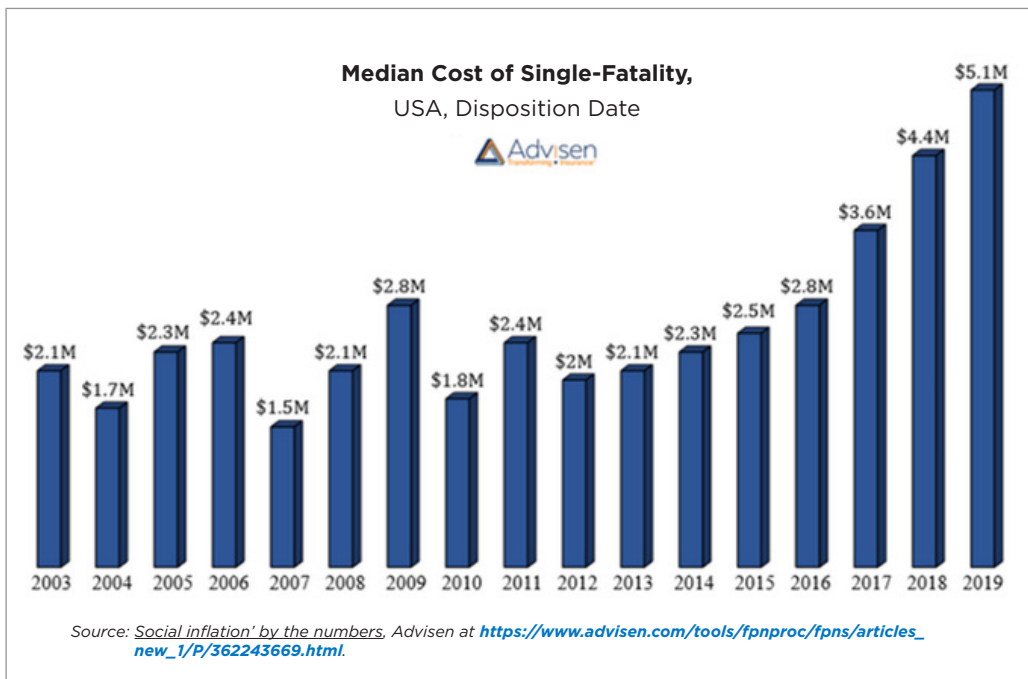
Average verdicts are seeing outsized growth, with a manifold increase in the last ten years. In 2010, average personal injury verdicts were \$39,300, and by 2020 they were \$125,366—a 319 percent increase even as we account for a decrease in the size of awards at the beginning of the pandemic.



Accounting for inflation does not explain the sizeable run up in lawsuit values. Insurers are now seeing inflation of median lawsuit values approaching 25 percent annually, with such verdicts being driven by the outsized growth in damage claims across all lines of business.



Insurers are seeing the same growth in fatality claims, as the median cost of a single-fatality loss has increased 242 percent in the last 17 years. If counted from its low point in 2007, the increase is 340 percent.<sup>6</sup>



<sup>6</sup> [https://www.advisen.com/tools/fpnproc/fpns/articles\\_new\\_1/P/362243669.html](https://www.advisen.com/tools/fpnproc/fpns/articles_new_1/P/362243669.html).



### Nuclear Verdicts

Similarly, nuclear verdicts—exceptionally high jury awards—have grown by many times in just the last few years. *The National Law Journal's* Top 100 Verdicts increased 350 percent, from \$64 million in 2015 to \$225 million in 2020.<sup>7</sup> And it is not just the size, but also the number of record verdicts, as one analysis showed there were 30 percent more cases during this time frame that pierced the \$100 million threshold than there were in 2015.<sup>8</sup>

### Personal Injury Billion Dollar Verdicts

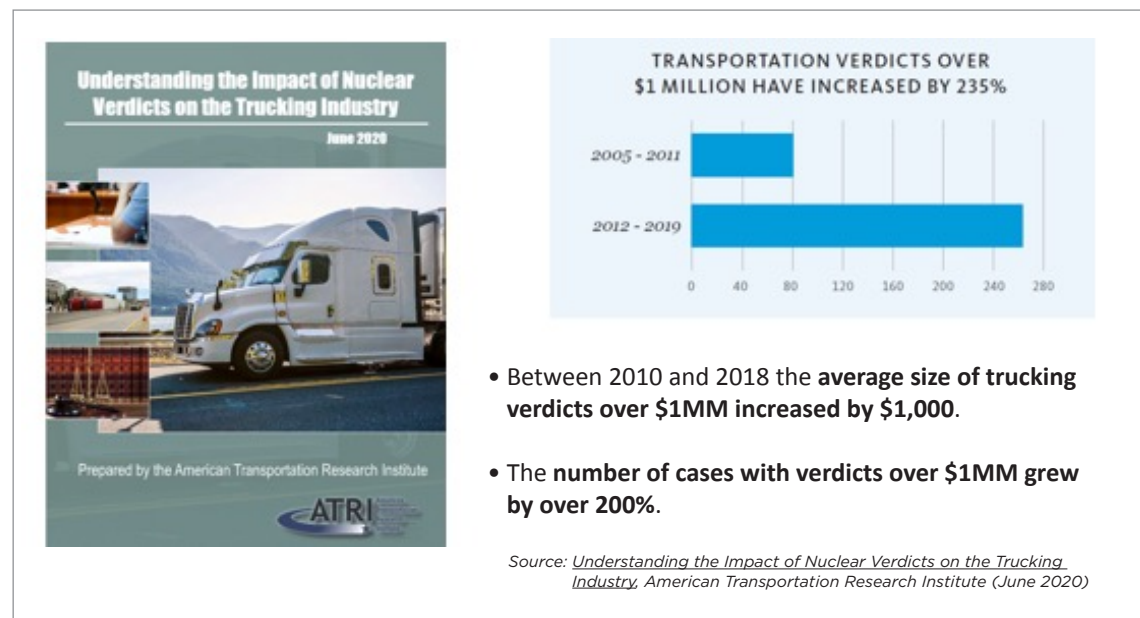
Insurers are also now seeing individual personal injury verdicts that exceed \$1 billion becoming increasingly common—numbers that were unheard of merely a few years ago.

- *Murray v. Janssen Pharmaceuticals* (Risperdal Product Liability) - \$8,000,000,000<sup>9</sup>
- *Pilliod v. Monsanto* (Roundup Product Liability) - \$2,055,000,000<sup>10</sup>
- *Dzion v. AJD Business Services* (Truck Accident) - \$1,000,000,000<sup>11</sup>

### Trucking and Workplace Class Action Verdicts

As with property insurance claims, insurers are seeing changes in other claims that are equally illustrative of this explosive trend in the size of verdicts.

For instance, according to the American Transportation Research Institute, the magnitude of trucking verdicts in the larger cases has increased 1,000 percent in under ten years, while the number of cases with verdicts over \$1 million has grown 200 percent.



7 2015 Top Verdicts, National Law Journal at <https://www.law.com/nationallawjournal/almID/1202755502233/>

2020 Top Verdicts, National Law Journal at <https://www.law.com/nationallawjournal/2020/09/01/top-100-verdicts-2020-chart/>.

8 Trends Driving Escalating Jury Verdicts, Constitution State Service at <https://www.constitutionstateservices.com/resources/trends-driving-escalating-jury-verdicts> (citing National law Journal verdict research).

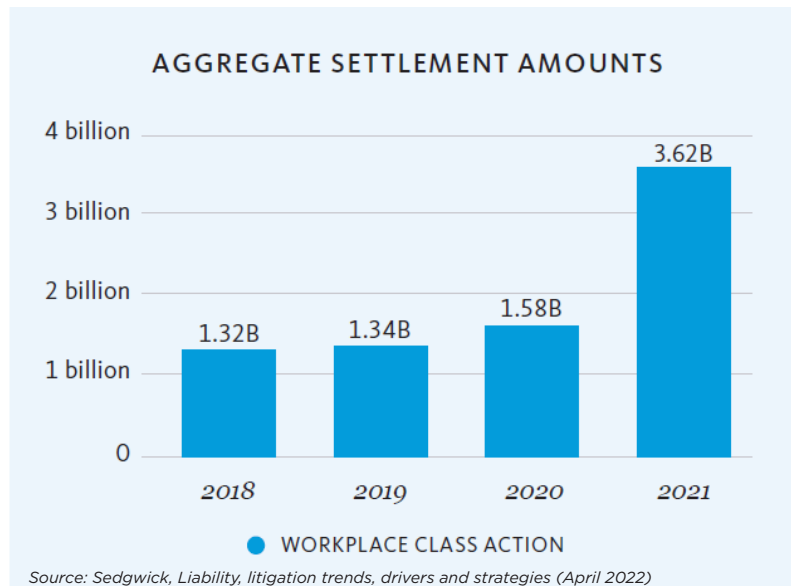
9 Armus, He said an antipsychotic drug caused him to grow breasts, Washington Post at <https://www.washingtonpost.com/nation/2019/10/09/johnson-johnson-risperdal-billion-verdict/>.

10 Cohen, \$2 Billion Verdict Against Monsanto Is Third to Find Roundup Caused Cancer, New York Times at <https://www.nytimes.com/2019/05/13/business/monsanto-roundup-cancer-verdict.html>.

11 Lewin, Two trucking companies hit with \$1 billion verdict, Florida Times-Union at <https://www.jacksonville.com/story/news/2021/08/24/connor-dzion-verdict-100-million-jacksonville-nassau-county/5571037001/>.

According to CaseMetrix, the average trucking verdict in the Southeastern United States in 2019 reached \$17.5 million, while from 2010-2014 the average was only \$2-3 million.<sup>12</sup>

Insurers are also seeing dramatic increases in damages involving workplace class actions, including a 273-percent increase in workplace class action settlement values in just the last four years.



Collectively, these negative changes have had a tremendous cost impact on households and businesses across the country, including in California, Florida, and Louisiana. The U.S. Chamber of Commerce's Institute for Legal Reform conducted an analysis<sup>13</sup> to quantify this impact and found the following.

#### U.S. Tort System costs on American Businesses and Families:

(Updated for increases in GDP and population)

- 2.3% of U.S. gross domestic product (GDP)
- \$529 billion per year
- \$4,323 per household
- Only 57 cents of every dollar in compensation goes to plaintiffs

These costs are impacting families and businesses every year and continue to grow.

## SOCIAL INFLATION

Social inflation is key among the underlying causes of legal system abuse driving lawsuit inflation. There have been many efforts to define social inflation through the years, even including one from Warren Buffett as far back as 1977. At its essence, social inflation reflects changing attitudes of what is fair compensation for harm and how to pursue it.

Plaintiff's lawyers embrace social inflation because it decouples claims from what ought to be fair and reasonable compensation for a legitimate loss. Instead, you have more damages, more claims and runaway juries as a result of lawyers and others using a host of tactics that have become routine in the last 20 years.

<sup>12</sup> [\\$1 Billion Verdict Builds on Nuclear Trend in Trucking Accident Cases, Association of Transportation Law Professionals.](#)

<sup>13</sup> Costs and Compensation of the U.S. Tort System, Institute for Legal Reform, US Chamber of Commerce at <https://instituteforlegalreform.com/research/costs-and-compensation-of-the-u-s-tort-system/> (adjusted for GDP and population growth)."

There are many drivers of social inflation that have been pushed in no small measure with the active encouragement of the plaintiff's bar. Several are worthy of particular attention.

### *Attorney Advertising*

Attorney advertising has increased significantly across the United States in recent years. Nationally, last year trial lawyers spent over \$1.42 billion on nearly 17.4 million ads through November 2021.<sup>14</sup> From 2017 to November 2021, spending on legal services advertisements increased by 16 percent nationwide, while the quantity of such advertisements during that period increased by 30 percent.<sup>15</sup> As explained in the state-specific sections below, these trends are particularly acute in California, Florida, and Louisiana, which collectively represent 27 percent of all national spending for lawyer advertising in 2021 at a price of almost \$388.1 million.<sup>16</sup> Given the high rates of return expected (according to a lawyer marketing website, "Effective marketing and advertising should have an average return of between \$10 - \$20 (gross) for every \$1 dollar you spend"),<sup>17</sup> there is little wonder why plaintiff's lawyers and their allies are pushing more and more advertising.

### *Reptile Theory*

Set forth in "Reptile: The 2009 Manual of the Plaintiff's Revolution" by David Ball and Don Keenan, the Reptile theory is a trial attorney tactic that aims arguments at a more primitive portion of the brain that is conditioned to seek safety and survival. The plaintiff's bar has increasingly used documented techniques to appeal to jurors' emotions and play on their sympathies. At its core, the reptile theory is a psychological ploy designed to trigger a "fight or flight" reaction, painting the defendant as hazardous, dangerous, or a menace to society. You can, of course, see the same appeals in the increasingly shrill advertising used to drive callers to advanced call centers. These ads are aimed at poisoning the jury pool as well as recruiting claimants.

### *Jury Anchoring*

Another example of manipulative trial attorney tactics is jury anchoring, where the plaintiff's attorney directly asks for an outsized damage award, often exaggerated when compared to the actual evidence and relying on animus toward defendants, which serves as a baseline from which the jury will be reluctant to retreat. An article in the *Iowa Law Review*, "Countering the Plaintiff's Anchor", describes it this way: "Numerous studies establish that the jury's determination of damages is strongly affected by the number suggested by the plaintiff's attorney, independent of the strength of the actual evidence (a psychological effect known as "anchoring"). Indeed, the strength of the effect appears so powerful that some researchers advise that 'the more you ask for, the more you get.'"<sup>18</sup> When you have \$1 billion judgments for single plaintiffs and plaintiff's lawyers requesting "only" 2 percent of worldwide revenue annually of multinational corporations to send them a message, there is little argument that these tactics appear to work.

### *Third-Party Litigation Financing (TPLF)*

The influx of investments from unknown third parties seeking to manipulate the U.S. legal system to profit off injury, known as third-party litigation financing, is also a growing challenge. In short, financiers provide funding for litigation in exchange for a percentage of the outcome and, seeking greater returns on their investments, encourage building up damages in personal injury claims and cases as well as increasing demand for litigation. TPLF injects unknown third parties into legal matters whose only interest is an increased return on investment, making civil justice a profit center for strangers to litigation. In addition to inflating claim values, TPLF may encourage consumers to have undue confidence in the strength of their cases and risk subjecting themselves to huge interest payments with little recovery of their own.

14 Legal Service Advertising in the United States: 2017-2021, American Tort Reform Association, at 4 ("Legal Ads") [https://www.atra.org/white\\_paper/legal-services-advertising-spending-2017-2021/#:~:text=Nationwide%20Report%20of%20Legal%20Services,claims%20across%20the%20United%20States.](https://www.atra.org/white_paper/legal-services-advertising-spending-2017-2021/#:~:text=Nationwide%20Report%20of%20Legal%20Services,claims%20across%20the%20United%20States.)

15 Id. at 4-5.

16 Id. at 14, 18 and 27.

17 <https://the-attorneys-atm.com/attorney-advertising-roi/#:~:text=Effective%20marketing%20and%20advertising%20should,in%20Personal%20Injury%2C%20the%20latter.>

18 Campell, et al., Countering the Plaintiff's Anchor: Jury Simulations to Evaluate Damages Arguments, 101 Iowa L. Rev. 543 (2016).

Of particular concern for insurers, capital is rapidly growing in this space, and approximately \$12 billion is now deployed in TPLF in the United States. The leading financier of litigation has seen its assets increasing exponentially, including a single, nearly \$1 billion investment from an unknown, foreign sovereign wealth fund. According to Bloomberg, even Harvard's investment arm has made a \$500 million investment in a financier.

And litigation financiers are not shy about their intent. As Allison Chock, the Chief Investment Officer with Omni Bridgeway f/k/a Bentham IMF, candidly admitted, "We make it harder and more expensive to settle cases," highlighting TPLF's distortion of our civil justice system. The challenge here is that few have any idea that litigation financing is involved in a case or claim, and the financiers fight hard to keep it that way.

#### *Medical Financing*

Medical financing is another form of claims-related financing, though it is specific to medical care for personal injury claimants. In medical financing, a third-party financier reaches a deal to pay only a portion of medical services or the actual billed amount and yet obligates the medical provider and claimant to stand by the full undiscounted bill, not disclose the discount and, in the case of the claimant, prevent them from submitting the bill for payment by their health insurer. Other forms of this practice exist, such as medical liens, letters of protection, assignments, and factoring. The intent of all of these arrangements is to increase the third party's recovery by enhancing the amount and kinds of treatment and collecting the difference between its actual or agreed value and the billed amount. Regardless of the version used, the practice drives claim build up<sup>19</sup> so third parties and some medical providers can profit.

#### *Phantom Damages*

Phantom damages is a term that encompasses the growing gulf between what is billed for services (often medical) and the actual value of those services. This trend is accelerating as unscrupulous lawyers, medical providers and even financiers seek to increase their income. The submission into evidence of billed amounts alone (instead of what was actually paid or could have been paid) as well as related medical financing, liens, and letters of protection are all vehicles being used to build up paper damages that then form the basis for inflated settlements or judgments. Phantom damages present a real political challenge because whole industries profit from them, from law to medicine to auto repair to finance. Ultimately, however, everyone pays more for products and services because of this practice.

#### *Public Nuisance Law*

Public nuisance litigation, originally intended to protect the public at large from common harms such as closed highways resulting from criminal activity, has been significantly expanded. Today, many types of private torts are being pursued as public nuisance claims, and the state has ceded its law enforcement function to private attorneys for their own profit. This has resulted in a previously unforeseen alliance between public institutions and the trial bar that advances litigation as a global solution for virtually any social ill, regardless of how politicized the issue is.

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<sup>19</sup> "Claim build up" refers to the inflation of otherwise legitimate claims. The practice may involve medical providers or others by increasing either or both the frequency of treatment or the expense of treatment, such that the treatments rendered may be of greater value than those that are customary, necessary and reasonable. The purpose is the same—to increase the cost of medical care to increase the cost of the claim, i.e., the claim is built up.

## FRAUD AND ABUSE

After any catastrophic event, “storm chasing” contractors often move into impacted areas, taking advantage of unwary homeowners by convincing them to make claims for damage that may not exist or taking money for repairs that are never made.

These are just two examples of insurance fraud and abuse, which refers to any intentional and criminal act perpetrated against an insurance company to illegally obtain payment. Insurance fraud and abuse can include a broad range of crimes that can be committed by many parties, though insurers most commonly see insurance fraud committed through acts such as inflating claims, misrepresenting facts on insurance applications, claiming a right to payment when no loss has occurred, or deliberately destroying property to reap a financial reward.

Fraud specifically related to property insurance claims represents a significant portion of the large and growing amount of insurance fraud in the United States—an issue that costs everyone. According to data from the FBI, the cost of insurance fraud (non-health insurance) is estimated to be more than \$40 billion per year, which translates to an additional \$400 - \$700 each year in insurance premiums for the average U.S. family.<sup>20</sup> Insurance fraud has grown into such a pervasive problem that the Coalition Against Insurance Fraud (CAIF) estimates that it occurs in about 10 percent of property casualty insurance losses.<sup>21</sup>

Following Hurricane Katrina—the costliest insured loss event in history—the FBI estimated that insurance fraud may have potentially accounted for up to \$6 billion of the \$80 billion in government appropriated reconstruction funding.<sup>22</sup> In Florida, Citizens Property Insurance Corp, the state’s largest property insurer, filed a lawsuit against Stremms law firm in 2020 after discovering the firm, working with a public claims adjuster and restoration company, also named in the suit, filed thousands of lawsuits against insurers, many of them on the same claim. According to the suit, Citizens alleged the defendants worked together to create an illicit enterprise to defraud insurers, in violation of state and federal anti-racketeering laws, in addition to creating false invoices and inflating the cost of claims. Citizens noted that Stremms, who was suspended from the practice of law, was responsible for as much as \$112 million in questionable claims and litigation filed from 2015 to 2020.<sup>23</sup> Insurers have seen similar schemes surface in numerous states, adding substantial costs to investigate and defend against such fraudulent claims.

### FBI: DISASTER-RELATED FRAUD SCHEMES

- False or exaggerated claims by policyholders.
- Misclassification of flood damage as wind, fire, or theft.
- Claims filed by individuals residing hundreds of miles outside the disaster-zone.
- Bid-rigging by contractors, falsely inflating the cost of repairs.
- Contractors requiring upfront payment for services, then failing to perform the agreed upon repairs.

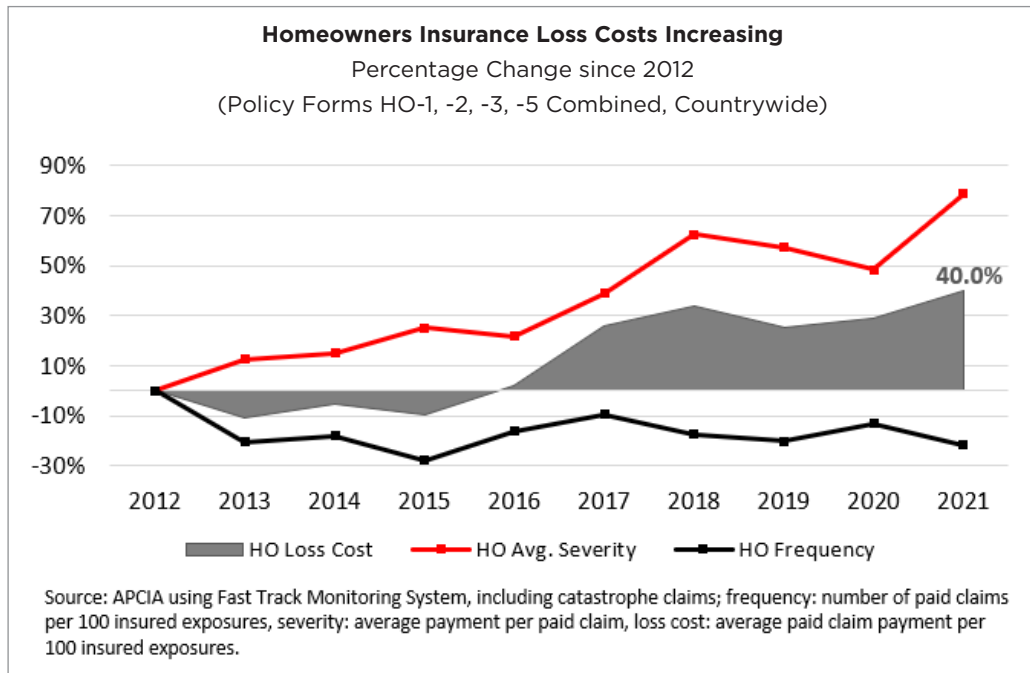
<sup>20</sup> <https://www.fbi.gov/stats-services/publications/insurance-fraud>.

<sup>21</sup> <https://insurancefraud.org/fraud-stats/>.

<sup>22</sup> <https://www.fbi.gov/stats-services/publications/insurance-fraud>.

<sup>23</sup> <https://www.insurancejournal.com/news/southeast/2022/05/13/667552.htm>.

With trends showing increasing loss costs in homeowners policies,<sup>24</sup> up 40 percent since 2012 driven by sharp increases in average severity, the total cost of fraud may also be expected to grow accordingly.



Legal remedies such as lawsuits filed by insurers under the federal Racketeer Influenced and Corrupt Organization Act (RICO) are the traditional responses to insurance fraud. However, ordinary legal remedies unfortunately do not address the full scope of the problem and require greater intervention to protect consumers from the shared financial and economic costs.

## GOVERNMENT INTERFERENCE

Insurers are facing increasing challenges in managing risk due to government mandates and interference. While there is overwhelming scientific evidence that climate change is a real and immediate threat, which is resulting in more frequent and severe natural disasters, the insurance industry has made significant improvements to be responsive in managing the resulting increase in catastrophic exposure. However, regulators are not allowing the voluntary market to function properly.

In disaster-prone states, once the conditions become ripe for legal system abuse and fraud, bad actors flood the state looking for their next big payday following major catastrophe events. The surge in losses from natural disasters amplifies the effect of these underlying issues, though when insurers begin to scrutinize losses where fraud and other abuse may be apparent, this may lead to an increase in consumer frustration, which in turn can lead to regulatory or legislative reactions. However, when regulators or legislators intervene in this manner, they too often fail to recognize the real underlying issues, and their actions often unintentionally exacerbate the symptoms and throw markets into further chaos.

For example, when additional adjusters are assigned to a claim to help adjust a loss, including investigating potential fraud such as a suspected falsified or inflated claim, this may be viewed as an excessive response or an effort to delay resolving the claim. In several states, lawmakers or regulators have begun to impose additional restrictions on insurers to force faster settlements for the benefit of consumers, but the

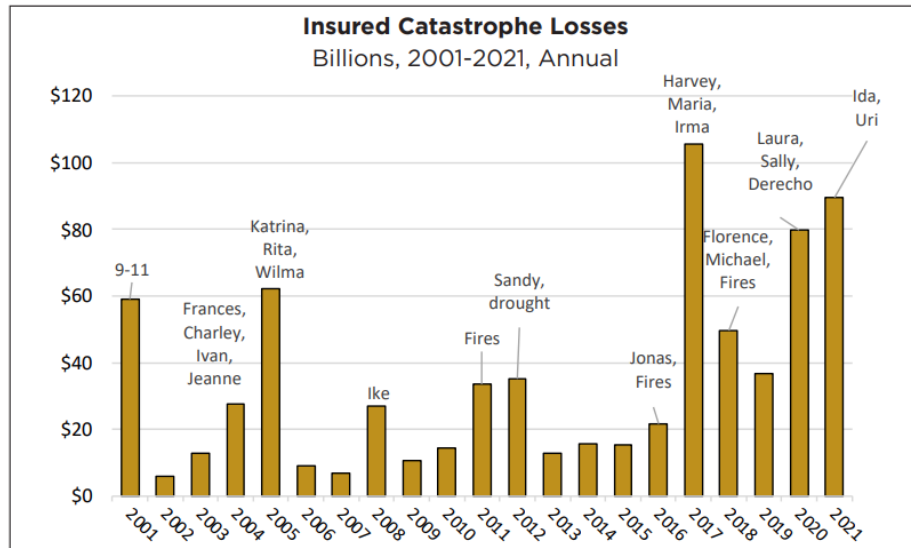
<sup>24</sup> Fast Track Monitoring System data.

unintended consequence is that these mandates limit the ability of insurers to thoroughly investigate claims to ensure accurate and reasonable settlements. Such issues ultimately compound the already rising trends in natural disaster losses and inflation, increasing the ultimate costs consumers must pay for insurance.

In 2020 and 2021, U.S insurers paid out \$176 billion for natural catastrophe claims alone, the highest total for a two-year period for such claims.<sup>25</sup>

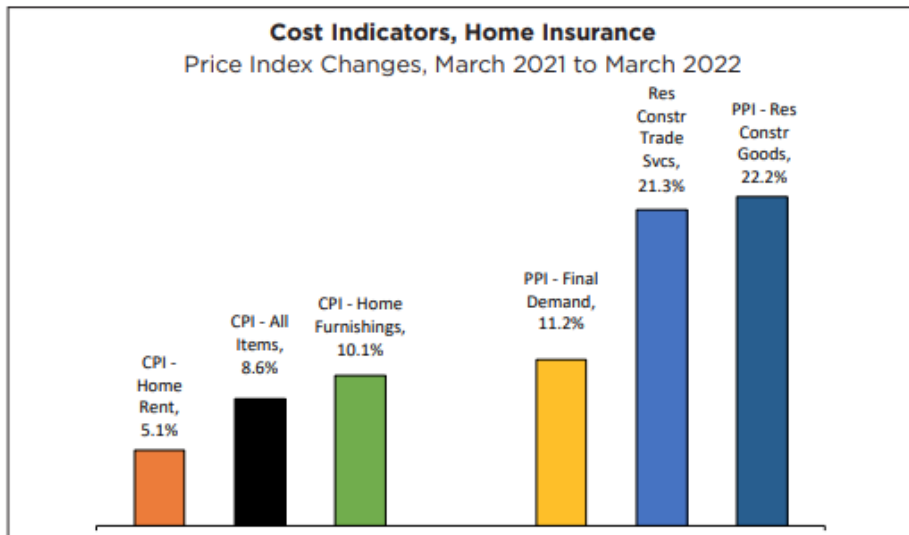
Inflation, recent supply chain issues, and increased demand for skilled labor and construction materials following the increased number of natural disasters in the last two years have also contributed recently to a significant increase in the costs to rebuild homes and businesses.

Reinsurers have similarly been impacted by these issues, resulting in an increase in property reinsurance rates of up to 40 percent in the United States overall for the July 1 renewals, according to reinsurance broker Gallagher Re.<sup>26</sup>



2001 includes \$32.5 bn in terrorism losses; other years are natural catastrophes only.

Source: Insurance Information Institute (III) and Aon for years 2019 and later, adjusted by APCIA to remove NFIP claims; III and Property Claim Services Unit of Verisk for years prior to 2019, excludes NFIP. Data as of Apr 28, 2022.



Consumer Price Index for All Urban Consumers: All Items, seasonally adjusted for Rent of Shelter, All Items, and Household Furnishings and Operations, seasonally adjusted. Producer Price Index by Commodity: Final Demand, seasonally adjusted and for Residential Construction Trade Services and Goods.

Source: Bureau of Labor Statistics. Data as of April 20, 2022.

25 Property Insurers Challenged by Skyrocketing Inflation and Natural Disasters, Feb 2022 at <https://www.apci.org/attachment/static/5963/>.

26 <https://www.reuters.com/article/reinsurance-premiums/property-reinsurance-rates-rise-by-up-to-50-in-florida-gallagher-re-idUSFWN2YH1WQ>

However, when state lawmakers focus only on expanding perceived consumer protections while making it more difficult and costly for insurance companies to operate and settle losses, and regulatory environments restrict insurers' ability to charge adequate rates or otherwise manage their overall exposure in high-risk markets, insurers are forced to reassess their capacity to meet policy obligations and/or consider pursuing other less volatile markets to avoid the threat of insolvency. Such government actions and constraints predictably lead to reduced availability of insurance in admitted markets, which often manifests itself through growth in surplus lines markets, a strong indicator of underlying problems in the admitted market.

## STATES OF DYSFUNCTION – A CLOSER LOOK

Florida, Louisiana, and California illustrate the challenges and constraints insurers are increasingly facing in numerous states. These case studies will highlight examples of rampant legal system abuse and claims fraud, mandatory moratoria on cancellations or non-renewals in the aftermath of disasters, delays in regulatory approval for rate filings amid surging loss costs, and legislative actions that continue to expand coverage benefits and create more hostile claims handling and legal environments.

These concerns, and the resulting market dysfunction, are most pronounced in these states—with Florida clearly the worst of the three—though the issues are not limited to these states alone. Insurers operating in states such as New York and New Jersey continue to face significant challenges and costs from legal system abuse, while other states, such as Oregon and Colorado, have similarly passed legislation adverse to insurers in the immediate aftermath of catastrophes. These actions, which result in higher claims costs and volatility, and when combined with regulatory pressure to disregard policy language in the settlement of claims, may prolong the property insurance market's ability to recover following record-breaking losses.

## FLORIDA

While Florida has not experienced a major damaging hurricane in the state since 2018, in calling the legislature into special session in May,<sup>27</sup> Florida's Governor noted that the state's insurance industry has experienced net underwriting losses exceeding \$1 billion for each of the past two years. The Governor found that "Florida's general tort environment related to property insurance" has led to thousands of frivolous lawsuits.<sup>28</sup> The rapid decline of Florida's property insurance market is a man-made crisis driven by extensive abuse of the legal system and rampant fraudulent roof replacement schemes.

### Legal System Abuse and Fraud

The Florida property insurance market has been no stranger to market challenges in the past, having faced issues ranging from significant wind exposure, mold, sink holes, assignment of benefits (AOB) fraud, and abuse for roof damage claims. However, as with the Governor, Florida's Insurance Commissioner has stated that Florida's underlying issue has really been litigation.<sup>29</sup>

Very recent data from Verisk confirms the Insurance Commissioner's conclusion. In its *2022 Executive Insights: Homeowners*, Verisk found that Florida would have a "much better than average (15 points or more below)" loss ratio if we excluded its loss adjustment expenses (LAE).<sup>30</sup> As Verisk concluded: "Excluding loss adjustment expenses (LAE), which may be impacted by litigation, **perils alone leave Florida with a positive loss ratio compared to the national average.**"<sup>31</sup> Loss adjustment expenses are, as its name suggests, the costs insurers incur to adjust, handle, investigate and resolve claims, and include the costs to defend and litigate claims.<sup>32</sup> In other words, as Florida's Governor and Insurance Commissioner have concluded, litigation has been the problem, and they should be recognized for their efforts to correct it.

27 Proclamation of Governor Ron DeSantis, April 26, 2022 at <https://www.flgov.com/2022/04/26/calling-on-the-legislature-to-hold-a-special-session-regarding-property-insurance/>.

28 Id.

29 See Viewpoint: The Cold, Hard Truth About Florida Litigation, Claims Journal (April 16, 2021) at <https://www.claimsjournal.com/news/southeast/2021/04/16/303179.htm>.

30 Verisk, 2022 Executive Insights: Homeowners at 5 (2022) <https://www.verisk.com/insurance/campaigns/executive-insights-homeowners/>.

31 Id.

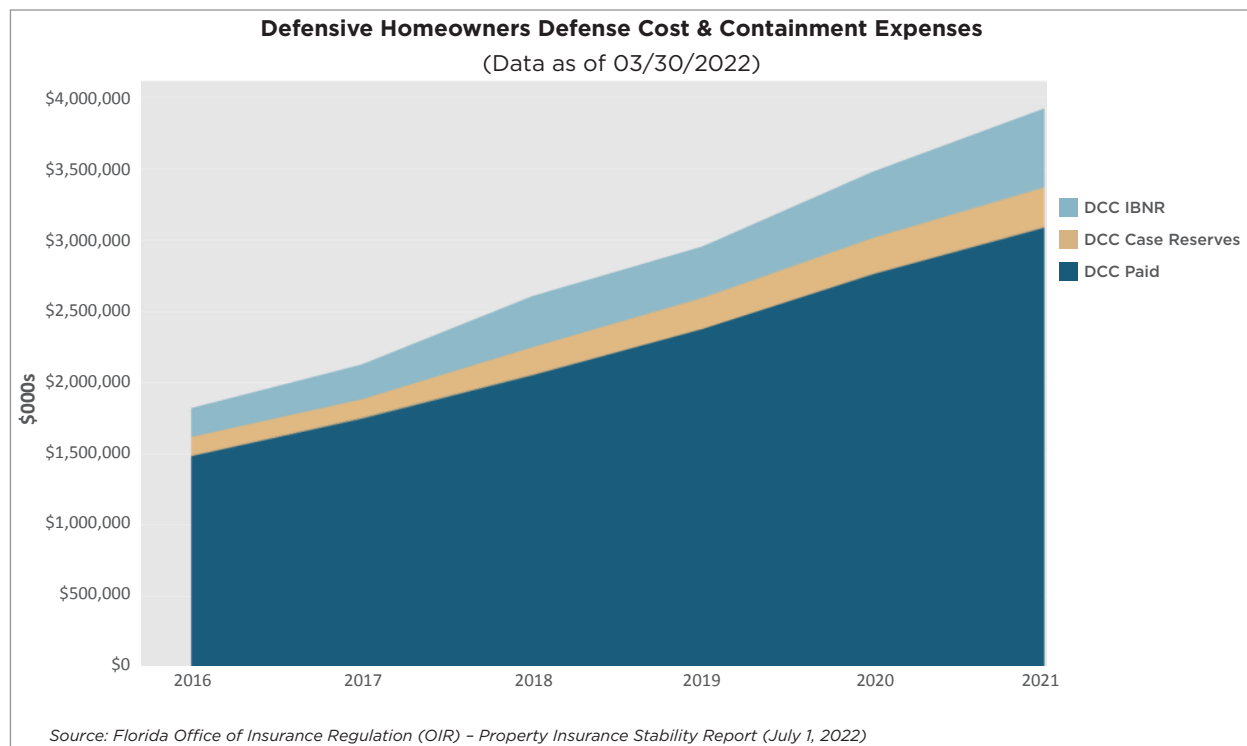
32 See Loss Adjustment Expense (LAE), Investopedia at <https://www.investopedia.com/terms/l/loss-adjustment-expense-lae.asp>.



Unfortunately, legal system abuse had been long incentivized in Florida, providing greater opportunities than in any other state to recover settlements in excess of policy limits. Until the very recent enactment of some reforms, Florida law contained a variety of mechanisms that greatly increase insurance payments beyond what could reasonably be called fair. Such mechanisms have included one-way attorney’s fees in property insurance claims, which permit policyholders filing lawsuits to recover legal costs when they prevail in court but prohibit insurers from doing the same; potential contingency fee multipliers, which under certain circumstances can multiply the value of attorney fees that insurers must pay when they do not prevail in court; as well as extracontractual bad faith damages against insurers.

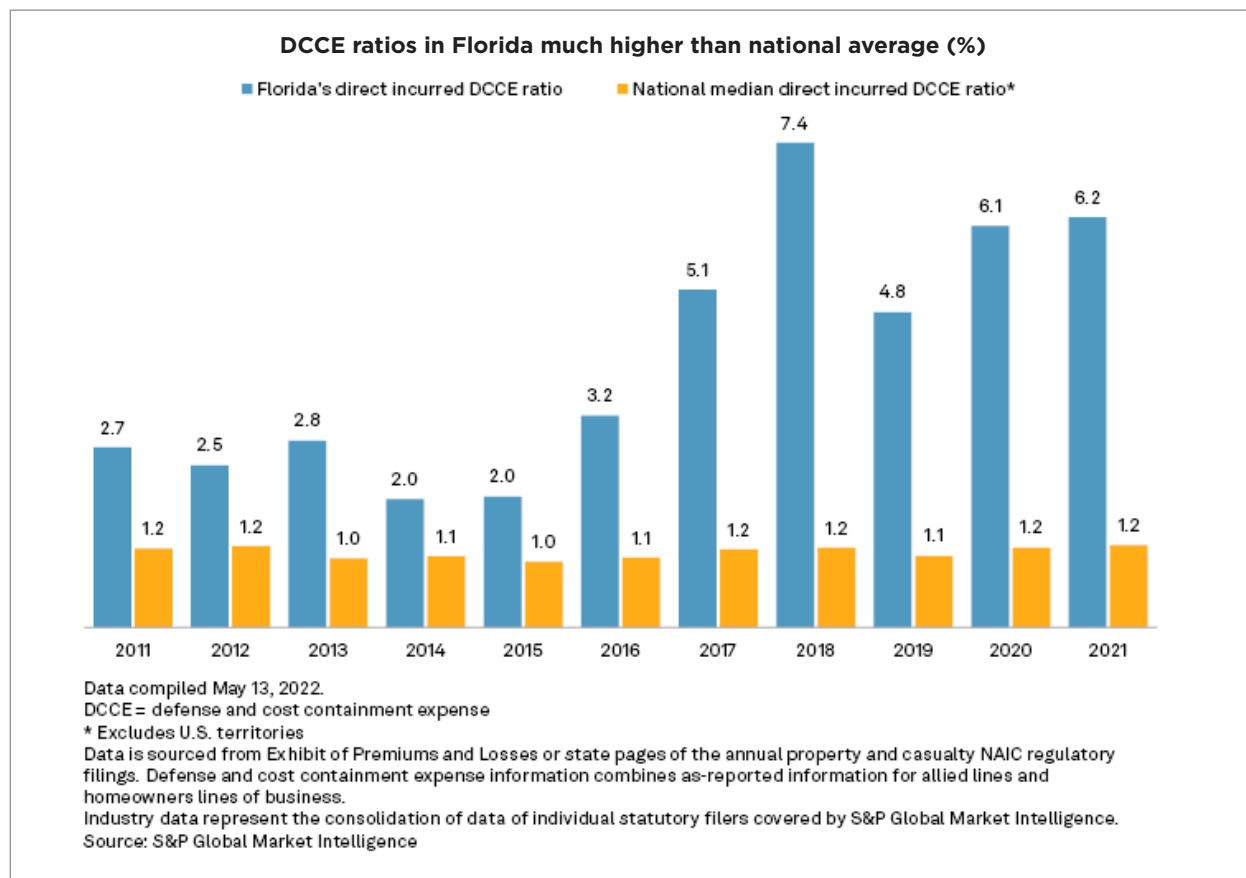
Driven by the state’s toxic legal environment, spending on local advertisements for legal services and claims soliciting in Florida increased by 53 percent between 2016 and 2020, and the quantity of those advertisements increased by 61 percent during that period.<sup>33</sup> By November of 2021, Florida’s legal advertising spending for the whole year exceeded \$208 million on more than 2.22 million ads.<sup>34</sup> This represents 14.7 percent of all legal advertising nationwide even as Florida’s population represents only 6.6 percent of the nation’s.<sup>35</sup> In addition, insurers have seen a surge of questionable and fraudulent claims as roofing schemes have proliferated in the state following Hurricanes Irma and Michael, further compounding the problem. Unscrupulous contractors often solicit and secure assignments of benefits from unsuspecting homeowners to force litigation and leverage legal loopholes to recover damages and hefty attorney fee awards through baseless claims. Florida House Member Tom Leek stated “it’s not about getting the insured a new roof. It’s about everyone making money in that process.”

The frequency of out-of-control claims litigation against property insurers has led to a significant spike in defense costs in recent years. According to data from Florida’s Office of Insurance Regulation (OIR), from 2016 to 2021, insurers’ defense costs have doubled, from \$1.5 billion to over \$3 billion.<sup>36</sup> Another study, *Florida’s P&C Insurance Market: Spiraling Toward Collapse*, by Guy Fraker, a risk consultant for Cre8tFutures, found that insurers paid \$15.3 billion for insurance lawsuits in Florida from 2013 to 2020, of which 71 percent funded plaintiff attorney fees, 21 percent represented defense costs and only 8 percent went to insureds.<sup>37</sup>



33 <https://www.atra.org/wp-content/uploads/2020/10/Legal-Services-Advertising-Report-CA-FL-MO-NY-PA-%E2%80%93-2016-2021.pdf>.  
 34 Legal Ads at 18.  
 35 Id.4, 18.; Population, Economic Research Service, USDA (“Population”) at <https://data.ers.usda.gov/reports.aspx?ID=17827>.  
 36 <https://floir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2022-isu-report.pdf>.  
 37 <https://www.insurancejournal.com/news/southeast/2021/01/20/598034.htm>.

This is out of balance and unfair to consumers generally, as such costs drive up insurance premiums for all. To illustrate, OIR further noted that Florida accounts for roughly 7 percent of the nation's homeowners claims but is facing 76 percent of the nation's homeowners insurance lawsuits over claims filed.<sup>38</sup> S&P Global highlighted in May 2022 that Florida carriers' Defense and Cost Containment Expense (DCCE) ratios reached 6.2 percent in 2021 for homeowners and allied lines, while the national median average was 1.2 percent.<sup>39</sup> To further put this into context, Guy Fraker noted that Florida insurers faced 100,595 lawsuits in 2021 claiming a total of \$7.8 billion in damages, while the rest of the country—49 states combined—faced a total of 24,700 lawsuits claiming \$2.4 billion.<sup>40</sup>



Third party lawsuit abuse reform measures were implemented in 2021, but challenges persisted with first party lawsuit abuse and bad faith issues. Almost a year after the passage of the 2021 property insurance reform bill (Senate Bill 76), which was intended to cut back on AOB related roof-damage claims abuse and lawsuits, litigated claims increased by 12 percent in March 2022.<sup>41</sup> AOB cases increased from 34 percent of total new cases in February to 37 percent in March.<sup>42</sup>

**Market Impact**

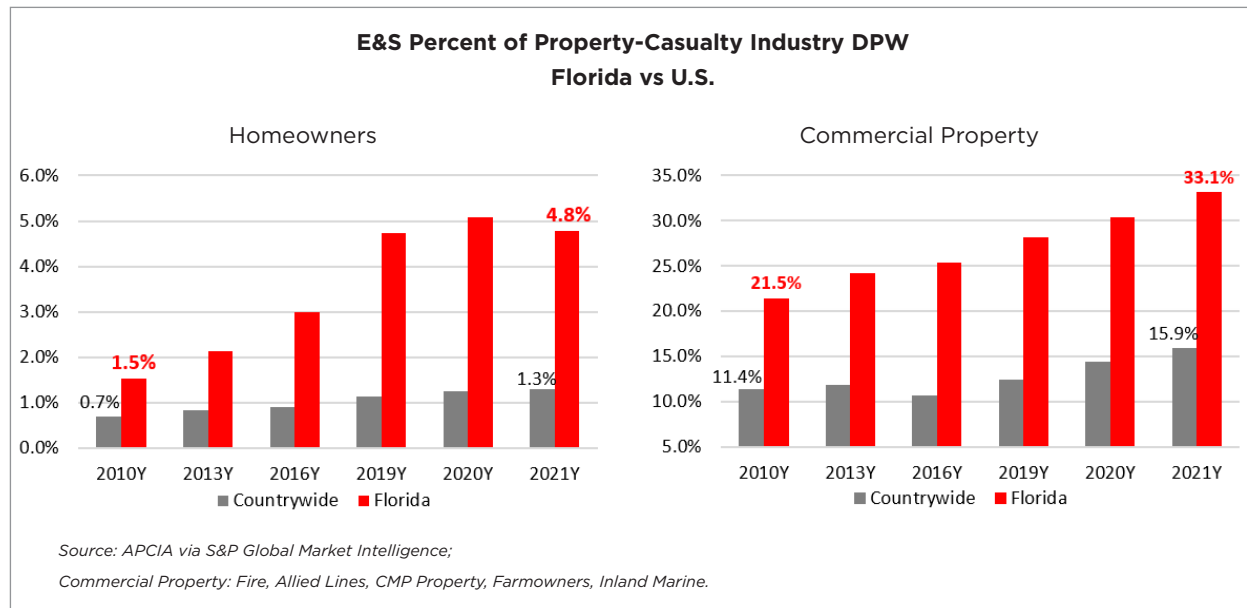
The impact of lawsuit abuse and fraud has reached crisis levels for a growing number of insurers, as losses have drawn down reserve capital while costs to secure additional capacity through reinsurance have spiked. According to Citizens Property Insurance Corporation of Florida (Citizens), 47 individual insurance subsidiaries in the Florida homeowners market reported collective losses of \$936.2 million in 2021, a trend that has been

38 <https://floir.com/docs-sf/default-source/property-and-casualty/stability-unit-reports/july-2022-isu-report.pdf>.  
 39 S&P Global Market Intelligence, "Fate of Florida property insurance market at stake as special session looms", May 19, 2022.  
 40 Id.  
 41 Insurance Insider: "Litigated claims rose 12% in March for Florida P&C insurers", April 19, 2022.  
 42 Id.

steadily increasing when compared to losses of \$590 million in 2020 and \$245.3 million in 2019.<sup>43</sup> These exclude four companies that were writing business at the end of the year and have yet to file their 2021 regulatory statements; some of these companies have faced financial difficulties and regulatory actions. According to Gallagher Re, mid-year reinsurance renewals in Florida saw increases begin at 5 percent to 15 percent for the best loss-free business and climb up to 20 percent to 50 percent for catastrophe-exposed loss accounts<sup>44</sup> as reinsurers similarly face growing underwriting losses.<sup>45</sup>

In 2022, five insurance companies writing homeowners coverage have been declared insolvent and placed into liquidation, after four companies in 2021 were similarly declared insolvent or required midterm cancellations, largely due to non-weather factors compounding actual weather-related catastrophe losses. Additionally, in 2022, over a half dozen insurers have received financial ratings downgrades, signifying increased risk that an insurer may not have adequate levels of capital to cover potential losses, while a growing number of leading homeowners insurers have announced a significant pullback or exit from the market to reduce their own exposure as the litigation environment continues to trigger dismal financial results across the market.

This has left hundreds of thousands of policyholders scrambling to find coverage with limited options, resulting in significant growth in the Excess and Surplus Lines market and rapid policy growth in Citizens, the state's insurer of last resort.

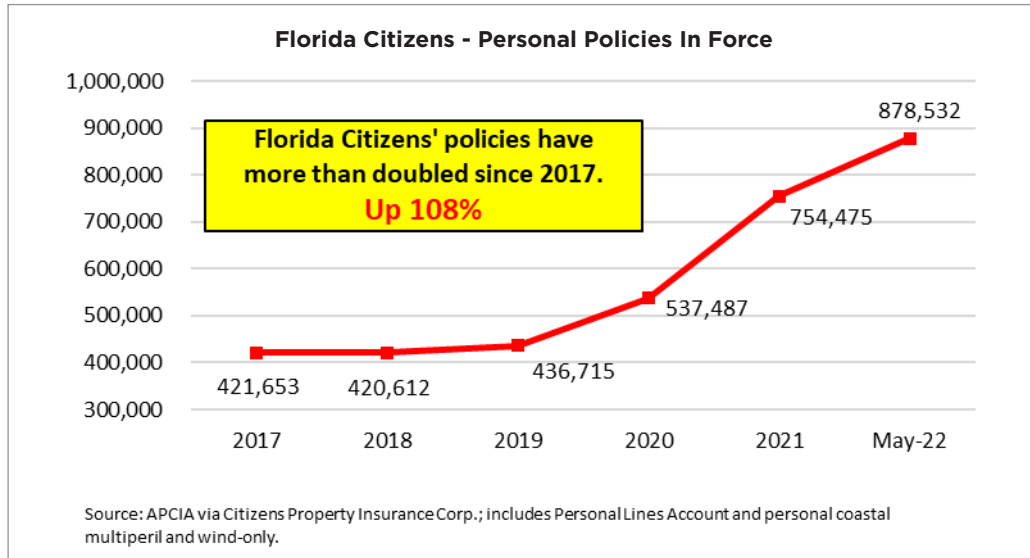


In December 2021, Citizens grew to 759,305 policies in force and is expected to top 1.2 million policies in force by the end of 2022, with projections that it may reach 1.5 million at the end of 2023, rivaling its prior peak of nearly 1.5 million policyholders in 2011.

<sup>43</sup> S&P Global Market Intelligence: "Losses mount for many Fla. property insurers in 2021", March 25, 2022.

<sup>44</sup> <https://www.businessinsurance.com/article/20220701/NEWS06/912350898/US-property-reinsurance-renewals-show-large-increases-Gallagher-Re-Arthur-J-Ga>.

<sup>45</sup> The "term loss-free" refers to losses from the perspective of the reinsurer. Specifically, while losses may be paid by the primary insurer, those losses are not high enough to trigger payments from the reinsurer to the primary insurer based on the terms of the contract.



The rapid expansion of Citizens amid predictions suggestive of an above-average hurricane season for a third straight year has insurers further on edge. Citizens faces statutory constraints on rate increases and has struggled to fully place reinsurance for its growing portfolio, increasing the potential for surcharges on Citizen’s policyholders, as well as assessments on insurers (which would ultimately be collected from and paid by their policyholders) should one or more major hurricanes strike the state and cause damages that exceed Citizens’ claims-paying capacity.

The rapidly deteriorating situation led the Governor to convene a special legislative session in May 2022 to address desperately needed property insurance and lawsuit abuse reforms in an attempt to stabilize the insurance market before the 2022 Atlantic Hurricane Season. While the Senate and House chambers overwhelmingly passed two bills, SB 2D and SB 4D, which were quickly signed into law, the reforms still came too late for many insurers, as additional rating downgrades and market pullback continue to plague policyholders in the state. In July, it was reported that potentially two dozen insurers may face rating downgrades from Demotech, which could impact millions of Florida policyholders, creating an increasingly dire situation requiring urgent attention. To prevent further meltdown in the market in the midst of hurricane season, OIR, in conjunction with Citizens, has proposed that Citizens provide an emergency reinsurance arrangement for impacted insurers so they can meet a financial rating requirements ‘exception’ under the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), thus temporarily preventing potential widespread insurance-related mortgage compliance defaults until after the 2022 hurricane season. With elections in November, the legislature will not return until March 2023 when June 1st reinsurance renewals are solidifying. Thus, any meaningful additional reform will require the consideration of another “special session” before then to give consumers relief in 2023. However, there are numerous court challenges to recently enacted legislative reforms as profiteers seek to roll back the needed prohibitions on unscrupulous behavior that has cost every family and business in Florida.

## LOUISIANA

Insurers face a similarly difficult tort environment in Louisiana, and back-to-back severe hurricane seasons that resulted in significant government intervention and mandates, such as legislation imposing burdensome claims-related requirements on insurers, have further exacerbated conditions that can incentivize legal system abuse. Legislative and regulatory overreactions in the immediate aftermath of disasters have led to the destabilization of the insurance market, thus creating a man-made crisis.

### Legal System Abuse

Louisiana has a well-earned reputation as one of the worst states for lawsuit abuse. In the annual “Judicial Hellholes” Report prepared by the American Tort Reform Foundation, Louisiana ranks as the sixth worst state in America.<sup>46</sup> The “Hellholes” report found that Louisiana’s lawsuit environment costs the state \$3.87 billion in lost economic activity and 22,550 jobs, while imposing a “tort tax” of \$451 per resident annually.<sup>47</sup>

A report from local lawsuit watchdogs reported an even bleaker picture:

Overall, excessive tort litigation in Louisiana results in direct costs of more than \$3.2 billion, state gross product losses of nearly \$4.7 billion and more than 46,000 lost jobs. Those costs are on top of state government losses of nearly \$244 million and more than \$203 million in losses for local governments each year, according to the report.<sup>48</sup>

The report, entitled “*Economic Benefits of Tort Reform*,” was prepared for Citizens Against Lawsuit Abuse and Louisiana Lawsuit Abuse Watch.<sup>49</sup>

Louisiana’s onerous bad faith laws contribute significantly to inflated claims payments and awards. Insurers who fail to pay claims or make a written offer to settle within 30 days of proof of loss may face penalties of up to 50 percent of the amount due, even for purely technical violations. To avoid incurring these massive penalties, which are meted out pursuant to highly subjective standards of conduct, insurers sometimes feel compelled to pay more than the actual value of claims as the lesser of two evils. In addition, some of the harmful practices that proliferated in Florida, such as abusive lawsuits resulting from assignment of benefits to contractors, have been seen in Louisiana.

These problems are exacerbated by an outsized amount of legal advertising compared to already inflated national averages. By November 2021, more than \$46.6 million was spent on all legal advertising in Louisiana during that year.<sup>50</sup> Louisiana accounted for 3.3 percent of all nationwide locally televised legal advertisements despite comprising less than 1.4 percent of the nation’s population.

### Recent Catastrophe Losses

Compounding the state’s difficult legal environment, Louisiana has experienced two consecutive severe hurricane seasons, which resulted in significant insured losses that triggered a wave of hostile legislation for insurers. According to the Louisiana Department of Insurance (LDI), insurers have received over 800,000 insurance claims in the wake of recent hurricanes, including Hurricanes Laura, Delta and Zeta in 2020 and Hurricane Ida in 2021,<sup>52</sup> the latter of which resulted in \$36 billion in insured losses and has been deemed the second costliest insured natural disaster in U.S. history.<sup>53</sup> While insurers have worked to diligently process the extensive volume of claims as timely and safely as possible amid the COVID-19 pandemic, a relatively small number of consumer complaints (representing less than 1 percent of overall claims) resulted in a disproportionate level of legislative and regulatory attention and response.

46 Judicial Hellholes, American Tort Reform Foundation (“Judicial Hellholes”) at <https://www.judicialhellholes.org/>.

47 Id.

48 Skinner, Study: Excessive litigation costs Louisiana \$3.2 billion, 46,000 lost jobs, The Center Square (March 14, 2022) at [https://www.thecentersquare.com/louisiana/study-excessive-litigation-costs-louisiana-3-2-billion-46-000-lost-jobs/article\\_a9686b0c-a303-11ec-8dd7-2b1d7edcc28b.html](https://www.thecentersquare.com/louisiana/study-excessive-litigation-costs-louisiana-3-2-billion-46-000-lost-jobs/article_a9686b0c-a303-11ec-8dd7-2b1d7edcc28b.html).

49 Id.

50 Legal Ads at 27.

51 Id. at 4, 27; Population; see also <https://www.atra.org/wp-content/uploads/2021/04/Louisiana-Legal-Services-Television-Advertising-Report-%E2%80%93-ATRA-%E2%80%93-Q4-2020-1.pdf>.

52 <https://www.wafb.com/2022/07/06/we-have-improved-system-insurance-commissioner-says-policy-holders-much-better-place-this-hurricane-season/>.

53 <https://www.iii.org/fact-statistic/facts-statistics-us-catastrophes>.

According to data from LDI, the highest volume of complaints stemmed from Hurricanes Laura and Ida, both strong category 4 storms, which resulted in individual complaint ratios of 1.0 percent and 1.2 percent, respectively. This means insurers handled roughly 99 percent of claims to consumer satisfaction in a very challenging post-hurricane situation that was further complicated by pandemic-related issues, including periodic labor shortages during heightened levels of COVID-19 infections and implementation of strict social distancing measures and new virtual tools to help safely handle claims.

### Government Interference

Nevertheless, to appear responsive to growing public concerns and media coverage, state lawmakers passed a flurry of bills intended to tighten the rules on insurance companies. Such actions create a more costly and adversarial claims handling environment for insurers, conditions which have historically led to increased premiums and less consumer choice in the marketplace as insurers face new, more challenging litigation rules post-disasters. Separately, in the immediate aftermath of Hurricane Ida, following heightened political pressure from state and federal officials, the Insurance Commissioner issued Directive 218, which ordered insurers in the state to set aside the plain language of an insurance policy filed with and approved by the Department of Insurance and provide extracontractual coverage for certain evacuation-related additional living expenses, thus undermining the sanctity of the contract.<sup>54</sup> A legal challenge ruled Directive 218 was invalid and unenforceable. The judge noted in his ruling that Directive 218 was an “improper exercise” of the Commissioner’s discretion and further called the Commissioner’s interpretation of the Prohibited Use policy language “wrong, manifestly erroneous, and shocking to the conscience of the tribunal”.<sup>55</sup>

### EXAMPLES OF RECENTLY PASSED LEGISLATION IN LOUISIANA

#### 2021

- stricter claims handling standards (HB 457)
- stricter claims payment and settlement requirements + new penalties (HB 585)
- adverse appraisal provisions + limitations on vendor referrals (HB 591)
- expanded DOI emergency powers (SB 29)

#### 2022

- adverse appraisal language + stricter claims handling & settlement timeframes (HB 936)
- expanded ALE coverage benefits (HB 83, HB 831)
- new catastrophe claims process disclosure form (SB 163)
- additional requirements imposed on out of state adjusters (HB 682, HB 935)

### Market Impact

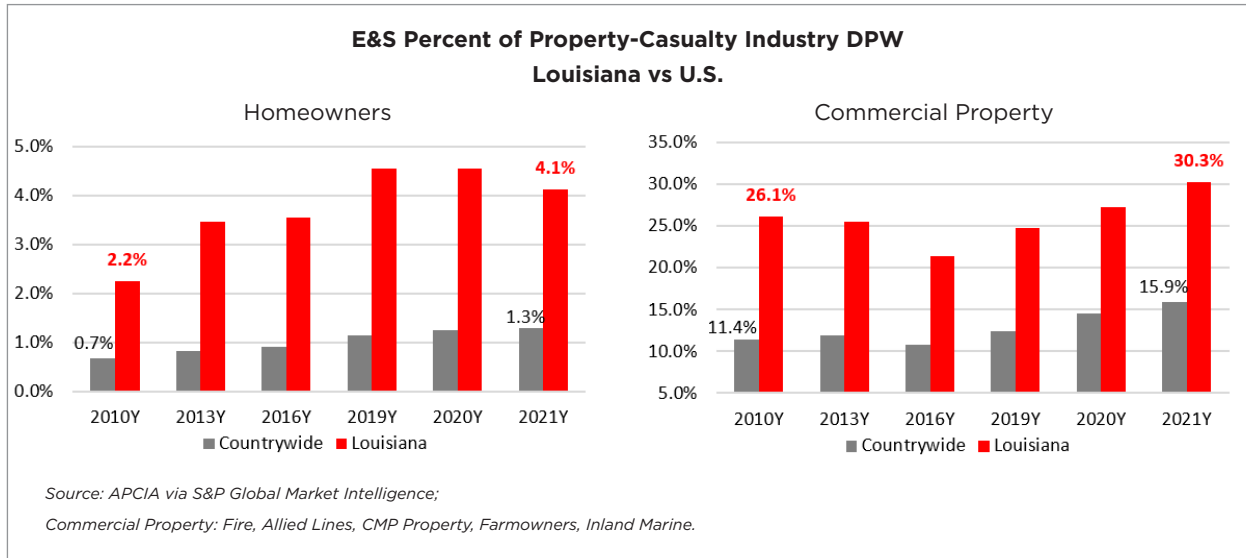
Contrary to the actions taken in the state following the 2004 and 2005 hurricane seasons, which aimed to stabilize the market and incentivize insurers to remain, recent actions by state lawmakers and the Insurance Commissioner have led to increased volatility and cost burden for insurers, compounding the effects of rapidly rising reconstruction costs due to severe inflation and demand surge, while insurers are still working to resolve claims from the 2020 and 2021 hurricane seasons. The effects of growing uncertainty amid deteriorating market conditions have resulted in at least 10 companies withdrawing entirely from the state since the calendar year 2020 and 2021 hurricanes, and at least five more ceasing to write new policies, according to LDI staff in a report issued in May. The May report further noted five additional insurance companies have become financially insolvent in the aftermath of recent storms and placed into receivership by LDI,<sup>56</sup> though more recent reports indicate this number has continued to grow, with up to seven insolvencies as of early August.<sup>57</sup>

<sup>54</sup> <https://www.lidi.la.gov/docs/default-source/documents/legaldocs/directives/dir218-cur-mandatorypaymentofex>.

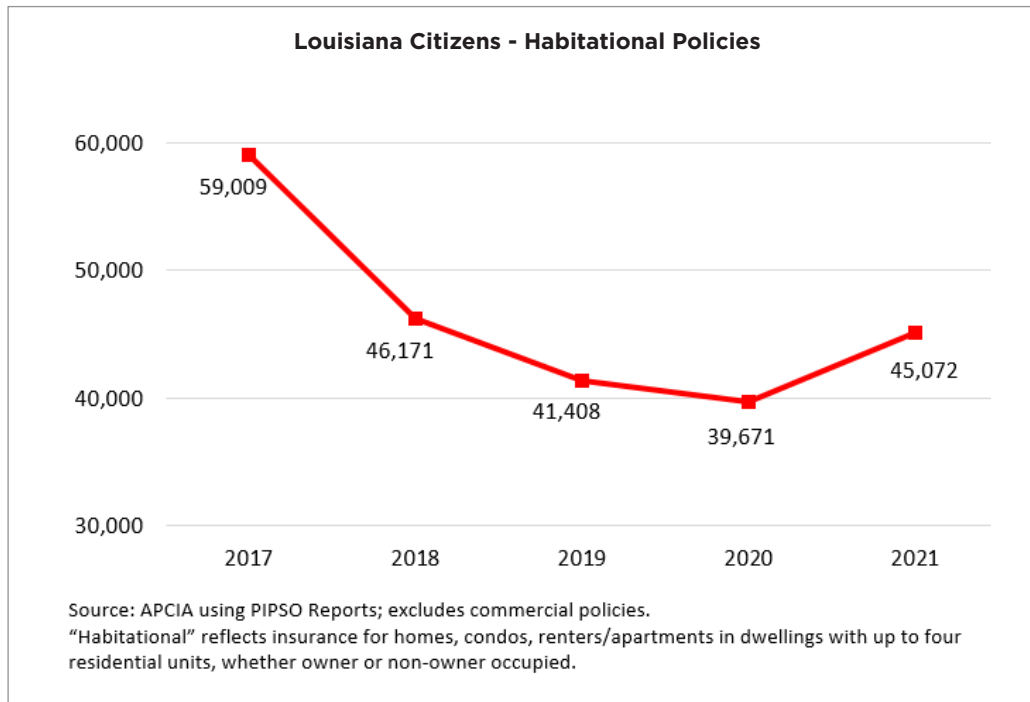
<sup>55</sup> <https://www.insurancejournal.com/news/southcentral/2022/07/13/675707.htm>.

<sup>56</sup> [https://app.lla.state.la.us/publicreports.nsf/0/a78b15fc0c7658d386258845007cb63c/\\$file/00026be3a.pdf](https://app.lla.state.la.us/publicreports.nsf/0/a78b15fc0c7658d386258845007cb63c/$file/00026be3a.pdf).

<sup>57</sup> <https://www.fox8live.com/2022/08/06/insurance-commissioner-hopeful-states-insurance-crisis-will-subside-by-end-year/>.



As in Florida, this has led to a significant expansion of policies being placed in Louisiana Citizens Property Insurance Corporation, Louisiana’s insurer of last resort, fueling insurer concerns of long-term policyholder assessments (collected by insurers but ultimately paid by policyholders) as an anticipated third back-to-back above average hurricane season gets underway.



## CALIFORNIA

The California property insurance market is also facing a growing affordability and availability crisis. California is a notoriously difficult and costly environment for legal system abuse. However, in the aftermath of unprecedented wildfire losses, insurers have faced a similarly unprecedented level of government interference through various legislative and regulatory changes, in addition to an increased potential for claims fraud, adding to market volatility. The barrage of mandates from the Insurance Commissioner and California-specific regulatory constraints that limit an insurer's ability to manage growing wildfire risk have made insurers increasingly concerned about the health of the market. As new proposals from the Insurance Commissioner continue to pile on increased exposure and costs for insurers, consumers are facing a deeper and unnecessarily prolonged insurance crisis.



### Legal System Abuse

California has incentivized more litigation with its statutory law than nearly any other jurisdiction. The primary example of this is the infamous Private Attorney General Act (PAGA), which deputizes citizens to enforce the state labor code, effectively handing state law enforcement authority to private individuals and, in particular, plaintiff's lawyers.

As a former legislative leader in the State Assembly said, "in many cases, these attorneys actually recruit faux plaintiffs to participate in their profiteering schemes. To do this, they spend millions of dollars each year blanketing television airwaves and dotting highways with advertisements for their legal services."<sup>58</sup> Spending on local advertisements for legal services and claims soliciting in California increased by 50 percent between 2016 and 2020, and the quantity of those advertisements increased by a stunning 115 percent during that period.<sup>59</sup> By November 2021, California's trial lawyers had spent \$132.6 million on nearly 1.2 million advertisements that year.<sup>60</sup> Another commentator observed that, "These suits have become a cottage industry for unscrupulous attorneys who turn California's labor laws and protections upside down. What's the main outcome? It's not protecting workers or people who are disabled. It's lining the pockets of these lawyers—all off the backs of small-business owners and consumers."<sup>61</sup>

These and other forms of lawsuit abuse impose considerable costs on everyday Californians. Indeed, California currently holds the dubious distinction as being the number one "Judicial Hellhole" in America, according to the most recent annual survey by the American Tort Reform Foundation.<sup>62</sup> The 2021-2022 "Hellholes" report found that "If California enacted specific reforms targeting lawsuit abuse, the state would save over \$22 billion."<sup>63</sup> However, the state has repeatedly chosen not to pursue reforms that might help benefit consumers by reducing costs, but instead has enacted numerous measures that result in higher costs and less choice for consumers.

58 Conway, In California, lawsuit abuse fuels rising prices, Capitol Weekly (November 18, 2021) at <https://capitolweekly.net/in-california-lawsuit-abuse-fuels-rising-prices/>.

59 <https://www.atra.org/wp-content/uploads/2020/10/Legal-Services-Advertising-Report-CA-FL-MO-NY-PA-%E2%80%93-ATRA-%E2%80%93-2016-2021.pdf>.

60 Legal Ads at 14.

61 Gomez, Protect small-business owners from lawsuit abuse, Cal Matters (December 10, 2021) at <https://calmatters.org/commentary/2021/12/protect-small-business-owners-from-lawsuit-abuse/>.

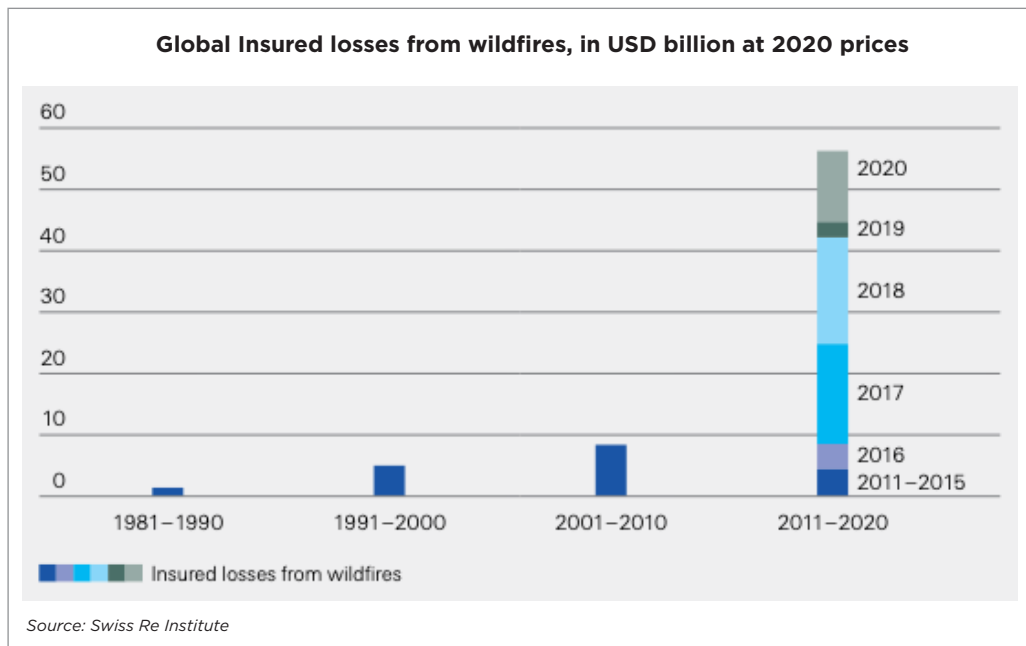
62 Judicial Hellholes at <https://www.judicialhellholes.org/>.

63 Id.



**Recent Catastrophe Losses**

Annual insured losses from wildfires have risen rapidly in recent years, to levels never before seen. According to Swiss Re, prior to 2015 the globe recorded only four years in which aggregated wildfire-related insured losses had topped \$2 billion (2021 USD). However, 2021 marked the seventh consecutive year that insured wildfire losses surpassed that threshold, largely due to catastrophic wildfires in California.



“Since 2017, there has been an average of 8,370 fires and 2.1 million acres burned in California per year, causing more than \$40 billion in combined losses for the insurance industry.”<sup>64</sup> Since 2017, according to Aon, eight of the ten costliest insured wildfire events in the world have occurred in California.

**Top 10 Costliest Insured Global Wildland Fires**

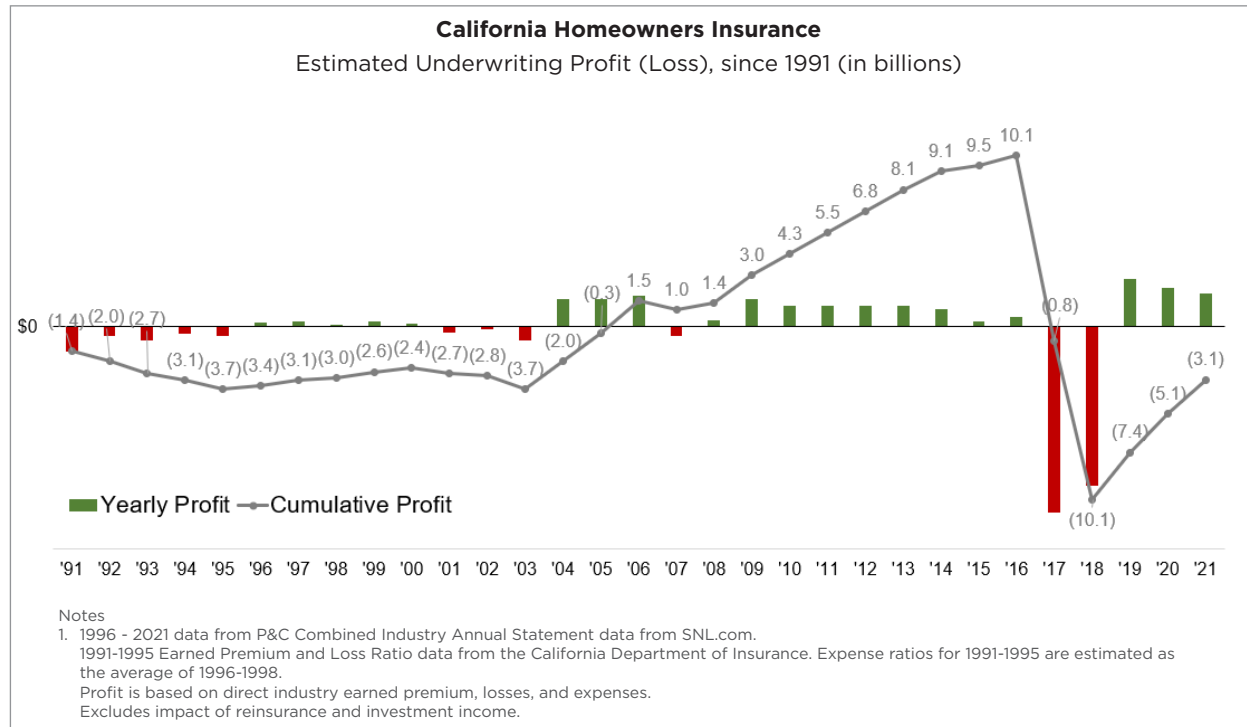
(\$ millions) shaded are CA-based wildfires since 2017

Year	Name	Location	Insured Losses in 2021 USD	Acres	Structures
2018	Camp	Butte (CA, USA)	\$10,750	153,336	18,804
2017	Tubbs	Napa & Sonoma (CA, USA)	\$9,560	36,807	5,636
2018	Woolsey	Ventura, Los Angeles (CA, USA)	\$4,520	96,949	1,643
1991	Oakland (Tunnel)	Alameda (CA, USA)	\$3,350	1,600	2,900
2017	Atlas	Napa & Sonoma (CA, USA)	\$3,300	51,624	783
2016	Horse Creek	Fort McMurray (CANADA)	\$3,200	1,456,810	3,244
2020	Glass	Napa & Sonoma (CA, USA)	\$3,070	67,484	1,520
2020	CZU Lightning Complex	San Mateo & Santa Cruz (CA, USA)	\$2,600	86,509	1,490
2017	Thomas	Ventura & Santa Barbara (CA, USA)	\$2,470	281,893	1,063
2020	LNU Lightning Complex	Lake, Napa, Sonoma, Solano & Yolo (CA, USA)	\$2,340	363,220	1,491

Sources: Triple-I, Aon

64 S&P Global Market Intelligence: “Use of surplus lines for homeowners coverage surging in California”, April 4, 2022.

To date, the peak insured wildfire loss years have been 2017, 2018, and 2020, resulting in global insured wildfire losses of \$18 billion, \$17 billion, and \$14 billion, respectively, primarily due to losses in California. According to an analysis from Milliman, the losses in 2017 and 2018 were so significant that they wiped out over 20 years of underwriting profits for homeowners insurers. Recent data indicates that on a cumulative basis, the homeowners line of business remains unprofitable, dating back to the 1991 Oakland Tunnel fire, as shown in the chart below.



**Government Interference and Fraud**

In the aftermath of these record-breaking losses, the California Legislature passed a series of bills intended to provide increased consumer protections and expand policy benefits following a declared disaster. However, these changes resulted in significantly higher costs and reduced insurer ability to manage exposure. This includes, for example, new regulatory authority to implement non-renewal moratoria in the immediate aftermath of a wildfire; extended timeframes for policyholders to collect full replacement cost and additional living expenses, which may amplify ultimate loss value due to inflation over time; the ability to combine coverages when policy limits for coverage to rebuild or replace the primary dwelling are insufficient, which is not contemplated under the policy; and coverage for additional living expenses during mandatory evacuations.

Given the significant expansion of coverage benefits and the unparalleled number of multi-million-dollar properties in California’s wildland-urban interface, which boasts some of the highest total insured dwelling and personal property values in the world, insurers in the state are increasingly seeing rampant solicitations from public adjusters and attorneys during and after wildfires.<sup>65</sup> This includes a growing number of reports of solicitations seeking to represent property owners in claims for smoke damage-only losses at properties that are well outside the proximity of a wildfire’s perimeter, such as more than a hundred miles away.<sup>66</sup> These “fire truck chasing” attorneys and public adjusters employ a variety of aggressive tactics to encourage homeowners to submit claims for personal property smoke damage,<sup>67</sup> then may work with a network of other vendors to exaggerate damage and inflate claims,<sup>68</sup> in order to force insurance companies to cover the total

65 <https://www.prnewswire.com/news-releases/fraudulent-smoke-and-ash-homeowners-claims-spread-with-wildfires-according-to-mercury-insurance-301587281.html>.  
 66 <https://news3lv.com/news/local/california-business-illegally-targets-northern-nevada-residents-for-smoke-damage>.  
 67 <https://www.cbsnews.com/sacramento/news/el-dorado-county-smoke-ash-wildfire/>.  
 68 <https://www.sdcda.org/content/preventing/fire/wildfire-assistance.pdf>.

replacement cost of personal property in the home, including, for example, electronics and furniture.<sup>69</sup> In response, insurers must increasingly engage additional environmental testing and experts to help investigate and defend against suspected fraudulent claims, significantly adding to overall claim costs.

The collective impact of these issues has created a need for significantly higher premiums in California to ensure that companies are able to pay future claims. However, the state's regulator, the California Department of Insurance (CDI), has been slow to approve rate filings, creating alarming rate inadequacy concerns. Insurers are constrained by Proposition 103, which requires prior approval from CDI to adjust insurance rates. This has severely limited insurers' ability to secure needed rate in a timely manner while simultaneously facing non-renewal moratoria that further limit their ability to manage overall exposure in high-risk areas.

This has prevented insurers from adapting to the new normal of major wildfires and adjusting their concentration of policy values that can be damaged in a single fire. This inability to adjust, coupled with the CDI's refusal to permit insurers to include the net cost of reinsurance in their rates, puts significant financial pressure on insurers, adversely impacting the willingness of other insurers to enter the California market. Additionally, insurers in California are prohibited from leveraging modern catastrophic probabilistic risk models (CAT models), which are sophisticated tools that help insurers more effectively incorporate evolving risk factors to model and project future losses, such as impacts from climate change, worsening drought, and other factors. While probabilistic models are permitted for use in ratemaking for earthquake and fire-following earthquake, under current California rules<sup>70</sup> it is illegal to include climate change projections in catastrophic fire insurance rates, and insurers must estimate their future losses using the average historic losses for the past 20 years. California's prohibition on insurers' use of climate change rating factors is ironic given that several cities and counties have been allowed to pursue lawsuits in state courts against energy firms, alleging damage from climate change.<sup>71</sup> Such practices also fail to reflect the extensive housing growth in the state's wildland-urban interface over the last decade or current environmental conditions, which include hotter and drier conditions due to climate change and the current megadrought gripping the U.S. west that is leading to fires igniting more easily and spreading more rapidly. In addition, significant fuel loads following decades of fire suppression policy, along with severe bark beetle infestations, have led to millions of dead or dying trees. These conditions have collectively led to what is now considered a year-round fire season that creates substantially higher exposure and potential catastrophic losses for insurers.

#### THE GROWING PRESSURE AFFECTING WILDFIRE CLAIMS COSTS

- Recent losses
- Increasing fraud
- Increasing wildfire exposure
  - Deteriorating environmental conditions (drought/climate change)
  - More homes and businesses in the WUI
- Expanded coverage benefits
- Inflation in reconstruction costs (labor & materials)
- Moratoria on non-renewals following wildfires

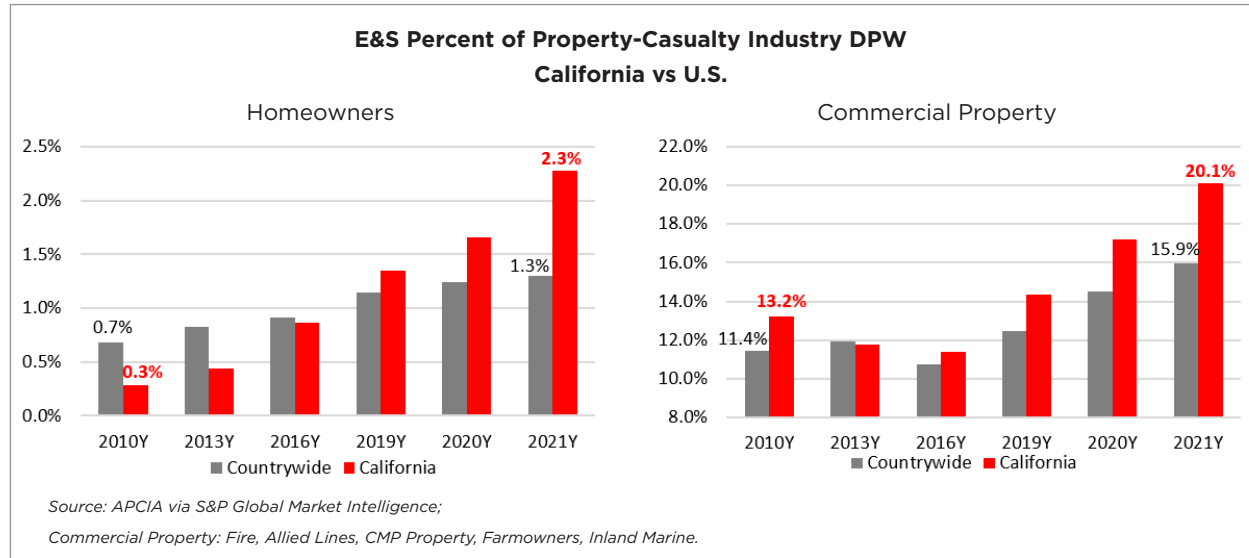
#### Market Impact

For the system to work properly, insurance rates must accurately reflect the risk assumed and be developed through sound standards of actuarial practice. However, faced with increasing risk and uncertainty in their ability to manage wildfire exposure, a growing number of insurers have made the difficult decision to significantly reduce their exposure in the state or, in some cases, exit the market or operate on a non-admitted basis, resulting in hundreds of thousands of policy non-renewals. The impacts have been particularly pronounced in the high-net worth end of the market, as insurers struggle to secure rate levels needed to provide coverage for many of the state's multi-million-dollar properties.

69 <https://www.claimsjournal.com/news/national/2022/07/18/311619.htm>.

70 10 CCR §2644.4 and §2644.5.

71 <https://www.reuters.com/legal/government/chevron-other-energy-giants-must-face-california-climate-change-cases-state-2022-04-19/>.



As insurance companies exit the homeowners admitted market or reduce their exposure, this has forced thousands of homeowners into the surplus lines (non-admitted) market or the FAIR plan, California's insurance market of last resort.<sup>72</sup>



72 <https://www.insurance.ca.gov/0400-news/0100-press-releases/2021/upload/nr17DataNon-RenewalsandFAIRPlan12202021.pdf>.

**Continued Governmental Interference**

The expansion of policies in the FAIR plan weighs heavily on admitted insurance companies, as the concentration of high-risk properties could result in substantial losses in any given year. Should losses exceed the FAIR plan's claims paying capacity, assessments would be made, forcing admitted market insurers (and ultimately their policyholders) to pay the shortfall. The combination of the inability to adjust underwriting or include reinsurance costs in rates, along with the threat of FAIR plan assessments, further pressures insurers; rather than attracting new insurers to the market to assist with spreading the burden of wildfires, the Insurance Commissioner's actions, while presumably well intentioned, have had the opposite effect.

Indeed, the insurance industry continues to face growing concerns as the Commissioner is pushing for additional changes to expand FAIR plan coverage. Such actions further increase exposure for admitted insurers and indirectly increase rate pressure over the long term. For example, the Commissioner issued orders in 2019 and again in 2021 to require the FAIR plan to offer consumers an HO-3 comprehensive insurance policy. This exceeds statutory limitations that only permit the FAIR plan to sell a basic property insurance policy. The FAIR plan has also struggled to secure rate filing approvals, instead requiring litigation to increase rates to reflect recent and significant increases in costs to settle claims. Most recently, the Commissioner is now pushing to significantly expand coverage for large commercial structures up to \$100 million, while potentially limiting the FAIR plan's ability to maintain reinsurance.<sup>73</sup>

The sheer volume of regulatory challenges and uncertainty insurers face in California is unprecedented, resulting in a crisis of confidence. Insurers and reinsurers can manage the impacts of wildfire, but the continued volatility resulting from the Insurance Commissioner's actions has created such significant challenges that California consumers are facing the hardest insurance market in a generation as the property insurance market in the state further contracts.

Due to the growing insurance availability and affordability challenges, insurers have pressed the Commissioner for increased access to tools such as wildfire catastrophe models, while simultaneously promoting the benefits of and need for risk reduction through mitigation to help stem the growing volume of losses. In response, the Commissioner proposed a rulemaking, 10 C.C.R. § 2644.9 Mitigation in Rating Plans and Wildfire Risk Models, which would allow limited use of catastrophe models to identify and segment risk while also requiring insurers to offer premium credits for wildfire mitigation. However, to comply with the rulemaking as proposed, insurers would face a significant cost burden due to extremely cumbersome underwriting and servicing requirements, coupled with significant technology costs to operationalize and automate processes. Insurers have highlighted that these troubling features will further increase underwriting expenses—costs which ultimately must be passed along to consumers—and have offered alternative, more cost-effective solutions to the Commissioner, to no avail.

Furthermore, the Commissioner remains unwilling to work with insurers and other stakeholders to identify a realistic path that facilitates increased access to wildfire catastrophe models. Instead, as currently proposed, the rulemaking provides no intellectual property protections, which means that while wildfire catastrophe models would be permitted for use, modelers may be unwilling to provide insurers access to their latest technology and tools if forced to reveal proprietary information, thus negating the intended goal of the rulemaking.

Should the proposed rulemaking be adopted in its current form, it will not only fail to resolve the property insurance market challenges but may exacerbate them further, thus continuing to erode the confidence of insurers in their ability to operate efficiently and profitably in this market.

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<sup>73</sup> <https://capitolweekly.net/fair-plan-cas-insurance-rates-havent-kept-pace-with-risks-costs/>

## THE ROAD TO RECOVERY

To fix broken property insurance markets, insurers have urged state lawmakers and regulators to focus on addressing the underlying issues roiling those markets. Legal system reform, anti-fraud measures, and promoting regulatory stability and mitigation to help reduce future losses are imperative to restoring market health in catastrophe-prone markets. Such actions are critically necessary in Florida, Louisiana, and California, where these issues are most pronounced, though they are not limited to these states.

### Legal System Abuse Reform

Many things need to be done to restore balance to the civil justice system. Several prominent reforms include addressing:

- Disclosure of Financing in Claims and Lawsuits – Light must be shined on the litigation and medical financiers who are driving claims build-up and lawsuits. This will permit judges and juries to consider the potential conflicts of interest and bias inherent in a practice that profits from larger claims and losses.
- More Transparency in Attorney Advertising – Steps must be taken to rein in irresponsible and often misleading advertising for legal services. Prominent disclaimers, truth in recovery claims, and explanations of attorney compensation are all needed.
- Eliminating Reptile Theory & Tactics – Judge and juries should hear facts, and not emotional appeals that aim to prejudice a party beyond what is supported in the evidence. To this end, jury anchoring should be strongly curtailed so that arguments conform to the facts in evidence, rather than a plaintiff attorney's entreaties for casino justice.
- Eliminating Phantom Damages – Simply put, the ultimate cost of services must reflect their actual value rather than some drastically inflated figure that aims to permit third parties such as unscrupulous medical providers, financiers, and attorneys to profit from someone else's suffering.
- Restore Original Intent of Public Nuisance Law – The historic role of public nuisance litigation, to protect the public at large from common harms, has been significantly expanded. Today, many types of private torts are being pursued as a public nuisance, and states have ceded their law enforcement function to private attorneys for their profit. Public nuisance law must be restored to its proper function, with limitations on when a state can share its law enforcement function with private citizens and proper guidance on what legitimately constitutes a public nuisance.

### Anti-Fraud Measures

Insurers are proactively working to protect their policyholders from the unnecessary cost burdens of rampant insurance claims fraud and abuse.

For example, insurers often establish special investigative units (SIUs) to help respond to reports of potential fraud and investigate suspicious circumstances surrounding claims. To address the broader social costs of insurance fraud, insurers also actively support organizations such as the National Insurance Crime Bureau (NICB), which leads a coordinated effort to combat and prevent insurance crime, and the Coalition Against Insurance Fraud (CAIF), which works to educate consumers and decision makers on the costs of fraud to individuals and communities.

Following extensive analysis of fraud issues by state, the insurance industry has developed anti-fraud model laws and regulations to support states in addressing the most common post-disaster fraud issues.

Model provisions may include:

- Prohibiting Deductible Rebating – Banning a practice often used to lure property owners into making a claim for “free” repairs.
- Disclosures – Requiring specific disclosures to property owners regarding the nature and extent of the damage assessed by a contractor.
- Right to Cancel – Providing property owners with the right to cancel repair contracts when the claims intended to fund them may not be covered in whole or in part, and not obligating them to pay for unnecessary repairs.

Insurers continue to advocate for adoption of these model laws and regulations in states where issues of fraud remain pervasive, in addition to ongoing advocacy to address state-specific issues such as the roofing fraud phenomenon in Florida.<sup>74</sup> For example, insurers support actions such as Florida’s recent establishment of a ‘fraud squad’ in 2021, which is tasked with pursuing major cases involving organized schemes to defraud. Such efforts have resulted in a 148 percent increase in uncovered instances of fraud, a 55 percent increase in arrests and a 129 percent increase in successful property fraud prosecutions across the state during the first 12 months of operation.<sup>75</sup> Insurers also work to help educate and protect property owners in the immediate aftermath of disasters through media outreach<sup>76</sup> and consumer education materials.<sup>77</sup>

Working together with policyholders, insurers can reduce the costly effects of fraud on all policyholders.

### **Regulatory Flexibility and Stability**

Insurers need greater regulatory flexibility and stability to manage growing natural disaster risk and the true cost of claims, while continuing efforts to reduce risk through mitigation.

To increase availability and affordability of insurance and restore broken property markets to good health, insurers need greater confidence they can operate in the admitted market in a financially solvent manner. To accomplish this, lawmakers and regulators must strike a healthier balance between affordability for consumers and the rate adequacy needs of insurers. Insurers must be given flexibility to collect adequate premiums reflective of the exposure. When the private market is allowed to function in this way with less volatility and counterproductive constraints, this leads to increased competition and ultimately greater consumer choice.

To further address affordability for consumers, lawmakers and regulators must focus on ways to reduce exposure and future losses. While climate change is expected to increase the frequency and severity of natural disasters, communities must be hardened to withstand natural catastrophes. Stronger homes, built for the local risks, should result in a meaningful decrease in future expected losses, enabling insurers to continue to provide affordable and available coverage for consumers.

<sup>74</sup> <https://www.nicb.org/news/blog/contractor-fraud-threat-market-stability>.

<sup>75</sup> <https://www.propertycasualty360.com/2022/07/29/florida-cfo-declares-insurance-fraud-squads-game-changer/>.

<sup>76</sup> <https://www.apci.org/media/news-releases/release/68116/>.

<sup>77</sup> <https://www.apci.org/attachment/static/6183/>.

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This report was produced in partnership between the American Property Casualty Insurance Association (APCIA), Reinsurance Association of America (RAA), Association of Bermuda Insurers and Reinsurers (ABIR), and Robert Hartwig, PhD, CPCU.

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The **American Property Casualty Insurance Association (APCIA)** is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

<https://www.apci.org/>

The **Reinsurance Association of America (RAA)**, headquartered in Washington, D.C., is the leading trade association of property and casualty reinsurers doing business in the United States. The RAA is committed to promoting a regulatory environment that ensures the industry remains globally competitive and financially robust. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. The RAA represents its members before state, federal and international bodies.

<https://www.reinsurance.org/>

The **Association of Bermuda Insurers and Reinsurers (ABIR)** represents the public policy interests of Bermuda's international insurers and reinsurers that protect consumers around the world. With headquarters and operations in Bermuda and with operating subsidiaries in the United States, United Kingdom and Europe, these carriers do business in more than 150 countries.

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