

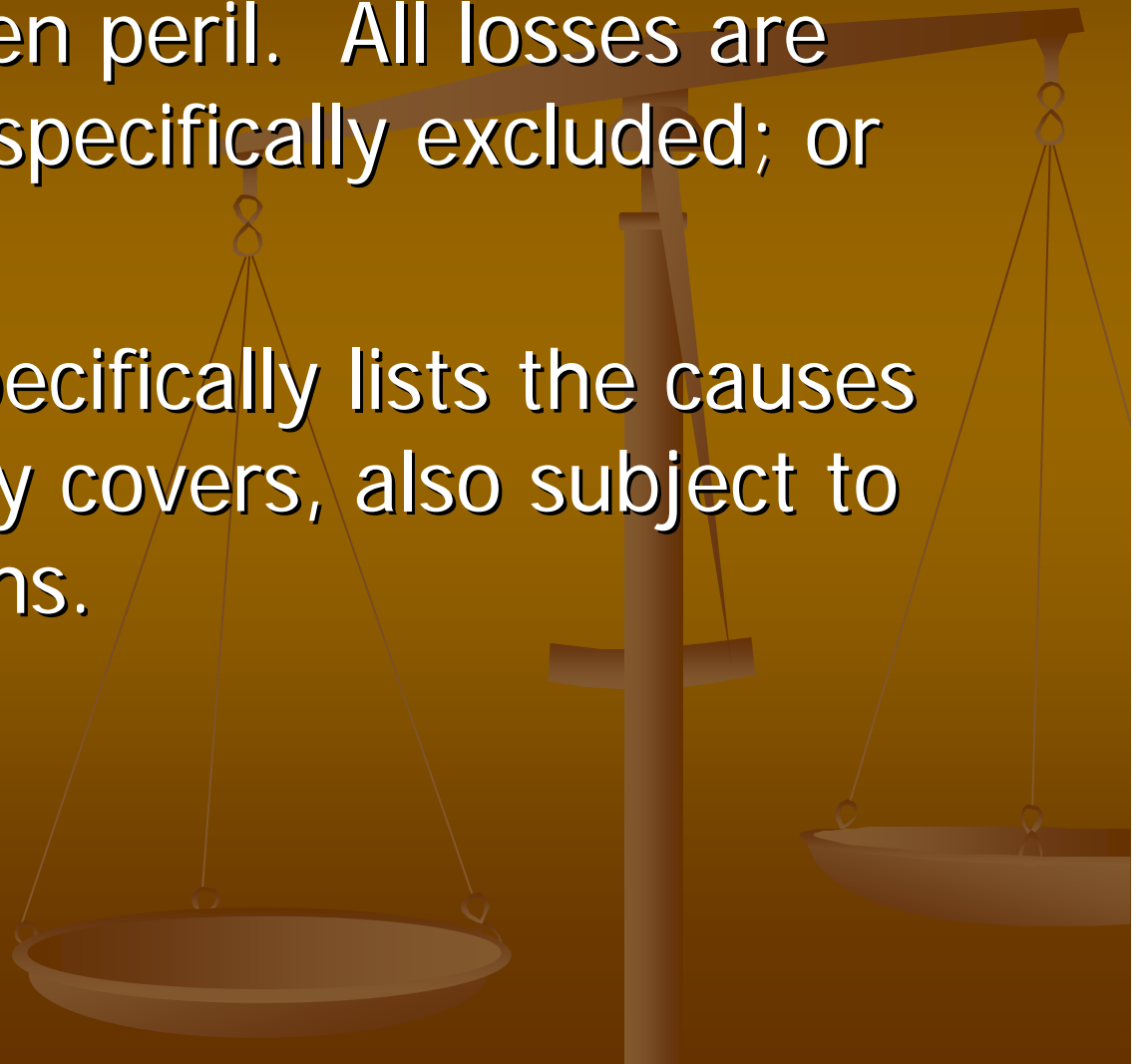


Universal Formula System for Allocating Insurance Loss Between Wind and Water Events

Director Scott H. Richardson, CPCU
South Carolina Department of Insurance

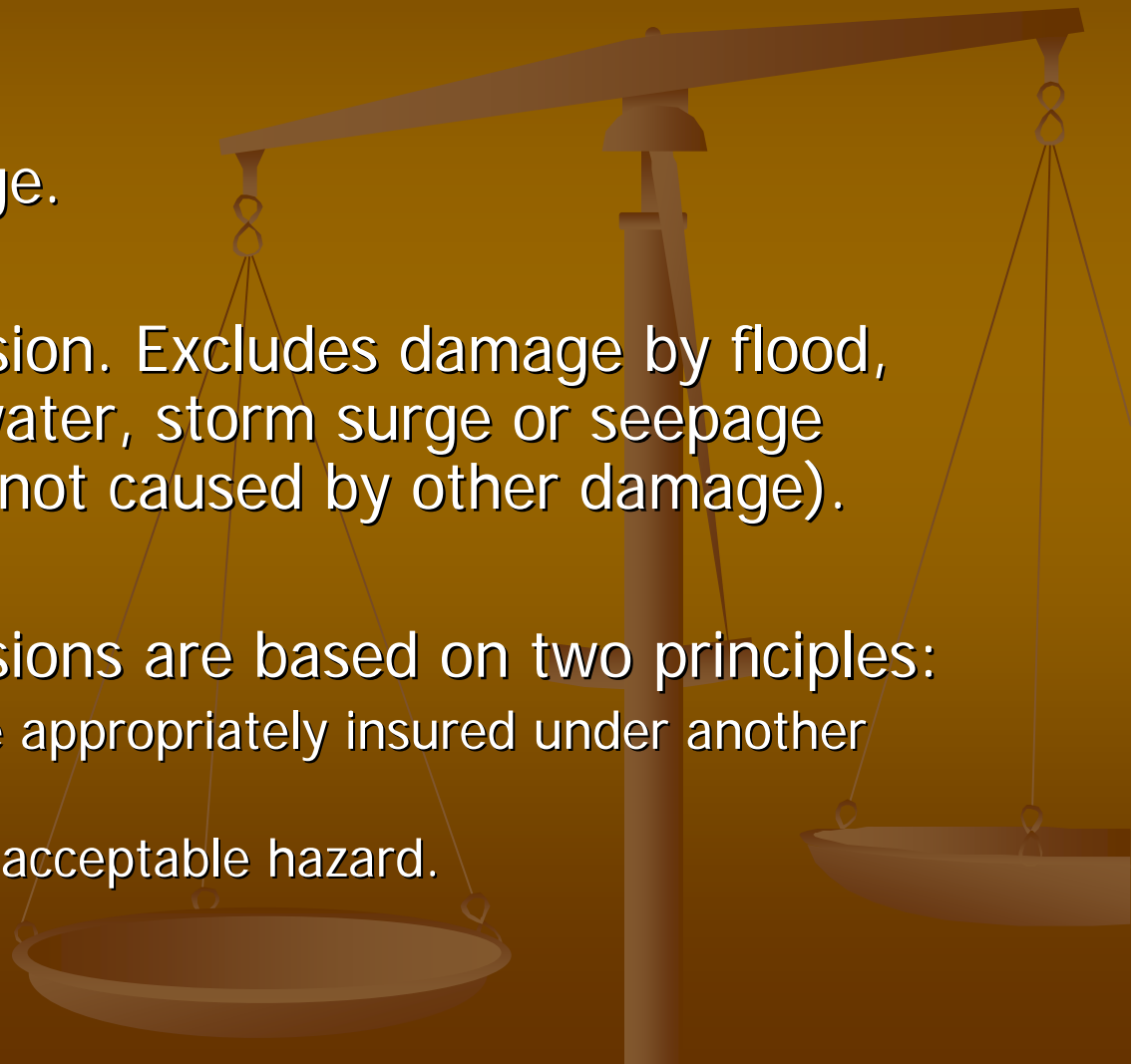
Property Insurance Policies

- “All Risk” or Open peril. All losses are covered unless specifically excluded; or
- Named peril. Specifically lists the causes of loss the policy covers, also subject to certain exclusions.



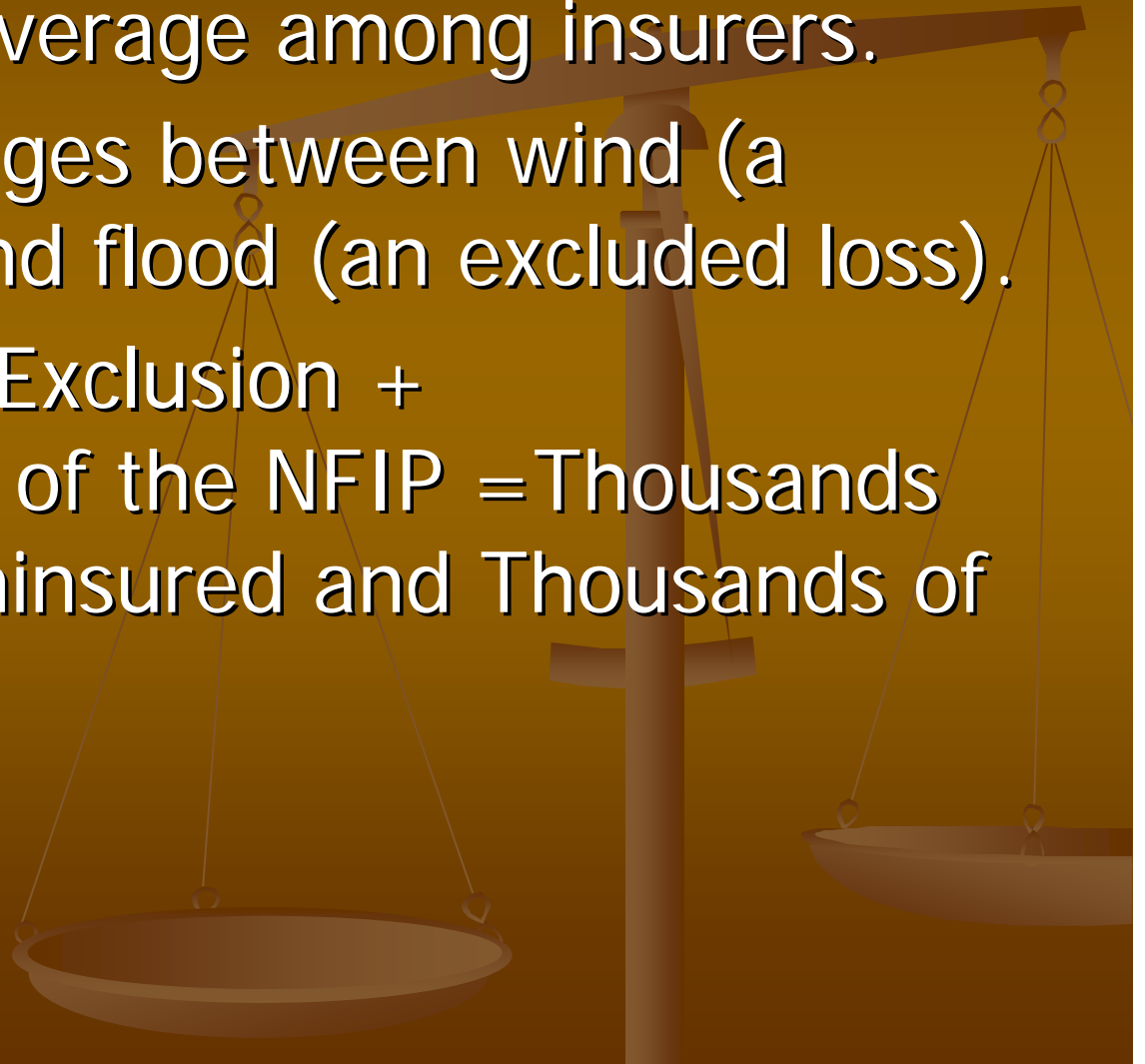
Both Types of Policies. . .

- Cover wind damage.
- Exclude water damage.
- Water damage exclusion. Excludes damage by flood, wind-driven rain or water, storm surge or seepage through openings (if not caused by other damage).
- Water damage exclusions are based on two principles:
 - Excluded peril is more appropriately insured under another product.
 - Peril represents an unacceptable hazard.



The Problem

- Apportioning coverage among insurers.
- Allocating damages between wind (a covered loss) and flood (an excluded loss).
- Water Damage Exclusion + Underutilization of the NFIP = Thousands of Properties Uninsured and Thousands of Claims Pending.

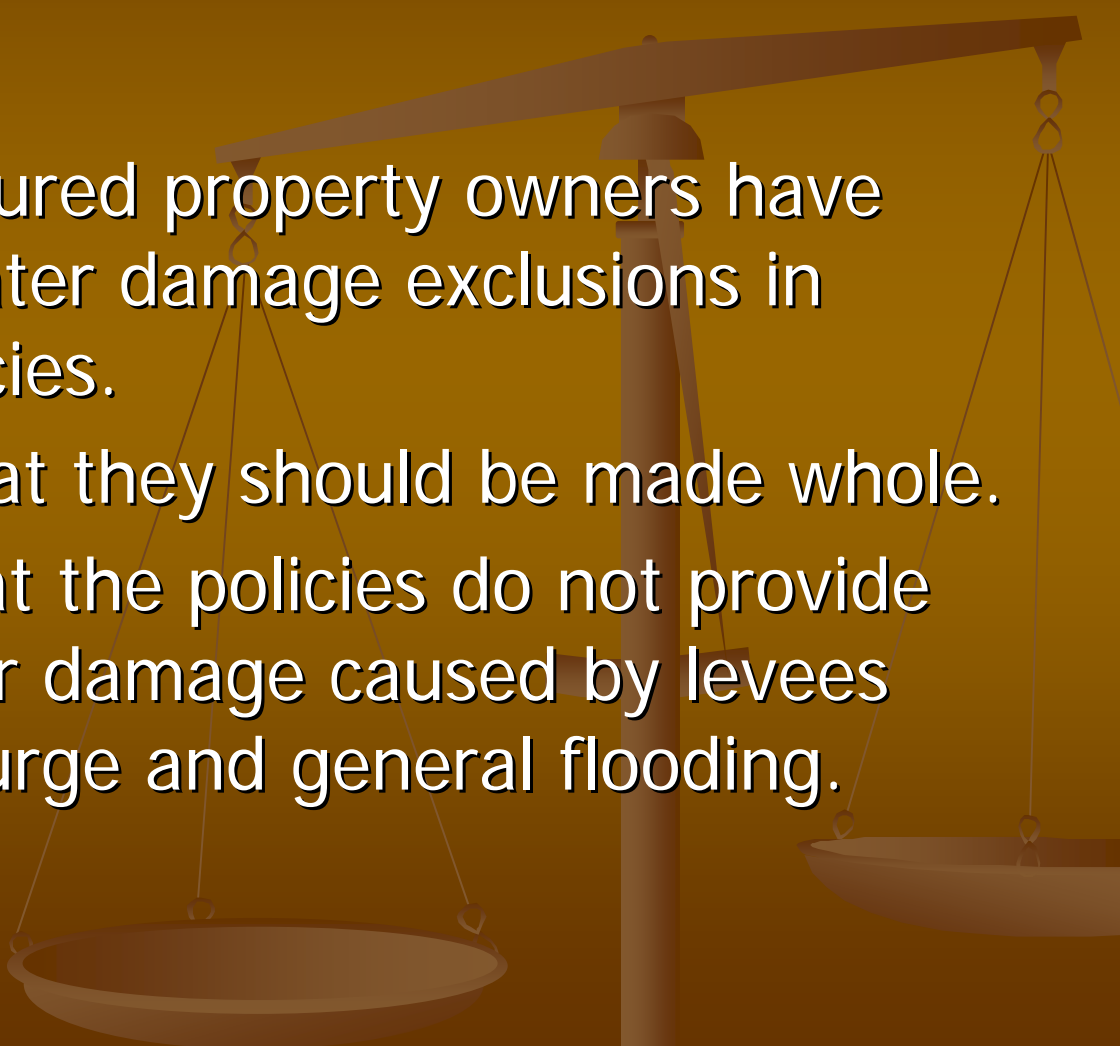


Policy Implications

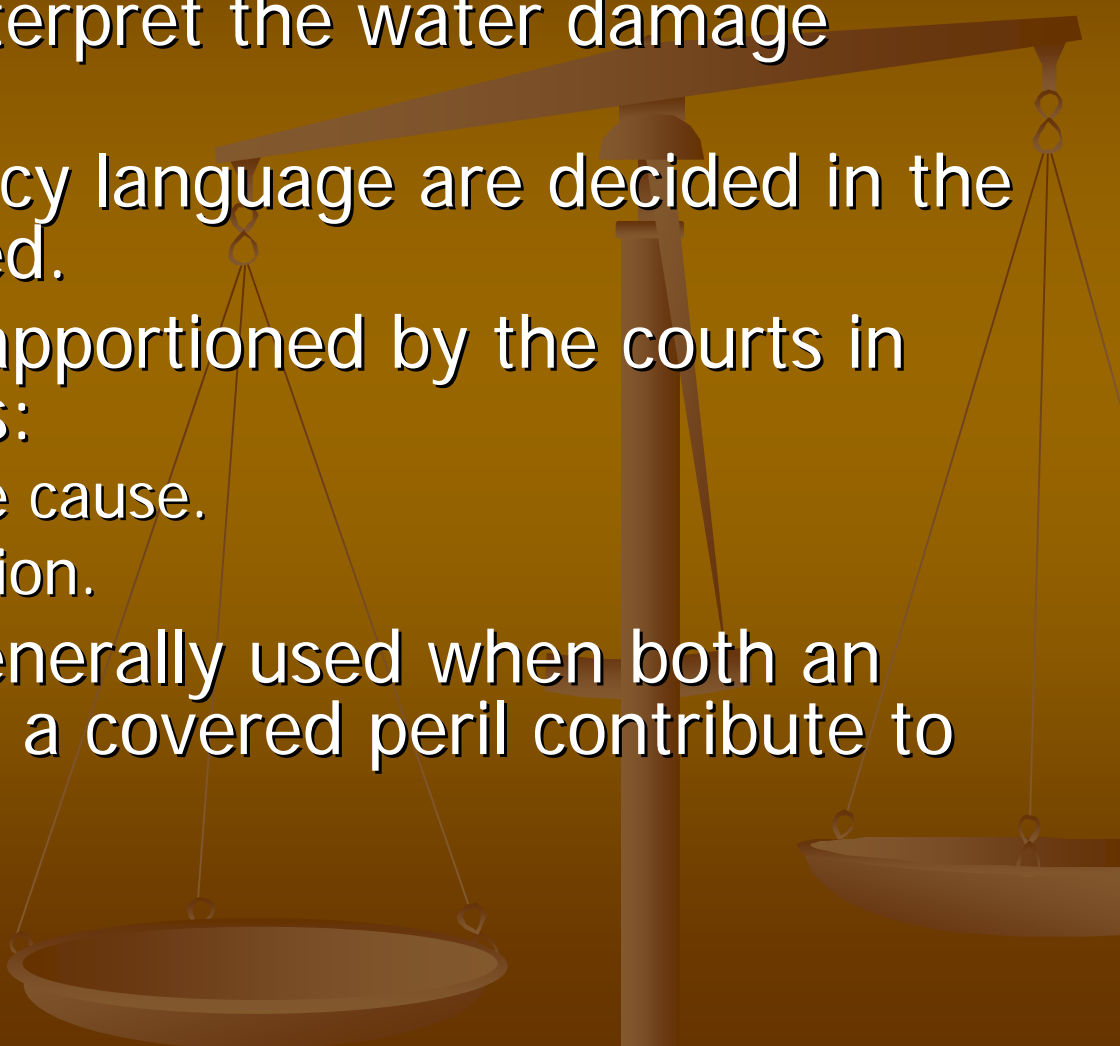


- Pending insured and uninsured property losses and their impact on property insurance markets, specifically along the Gulf and Atlantic Coasts.
- Assertions that insurers have shifted the cost of damages to the flood insurance program through policy exclusions.
- Unreliable flood maps.
- As a result:
 - Congress is considering legislation that would:
 - Mandate an all perils policy.
 - Add wind to the NFIP.
 - Claim delays and uncertainties related to coverage have resulted in extensive litigation.

Impact of Water Damage Exclusions and Underutilization of NFIP

- Litigation.
 - Uninsured and insured property owners have focused on the water damage exclusions in homeowners' policies.
 - Insureds argue that they should be made whole.
 - Insurers argue that the policies do not provide coverage for water damage caused by levees breaking, storm surge and general flooding.
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Apportionment of Loss

- How will courts interpret the water damage exclusions?
 - Ambiguities in policy language are decided in the favor of the insured.
 - Generally, loss is apportioned by the courts in the following ways:
 - Efficient proximate cause.
 - Concurrent causation.
 - These tests are generally used when both an excluded peril and a covered peril contribute to the loss.
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Legal Issues

Causation Theories

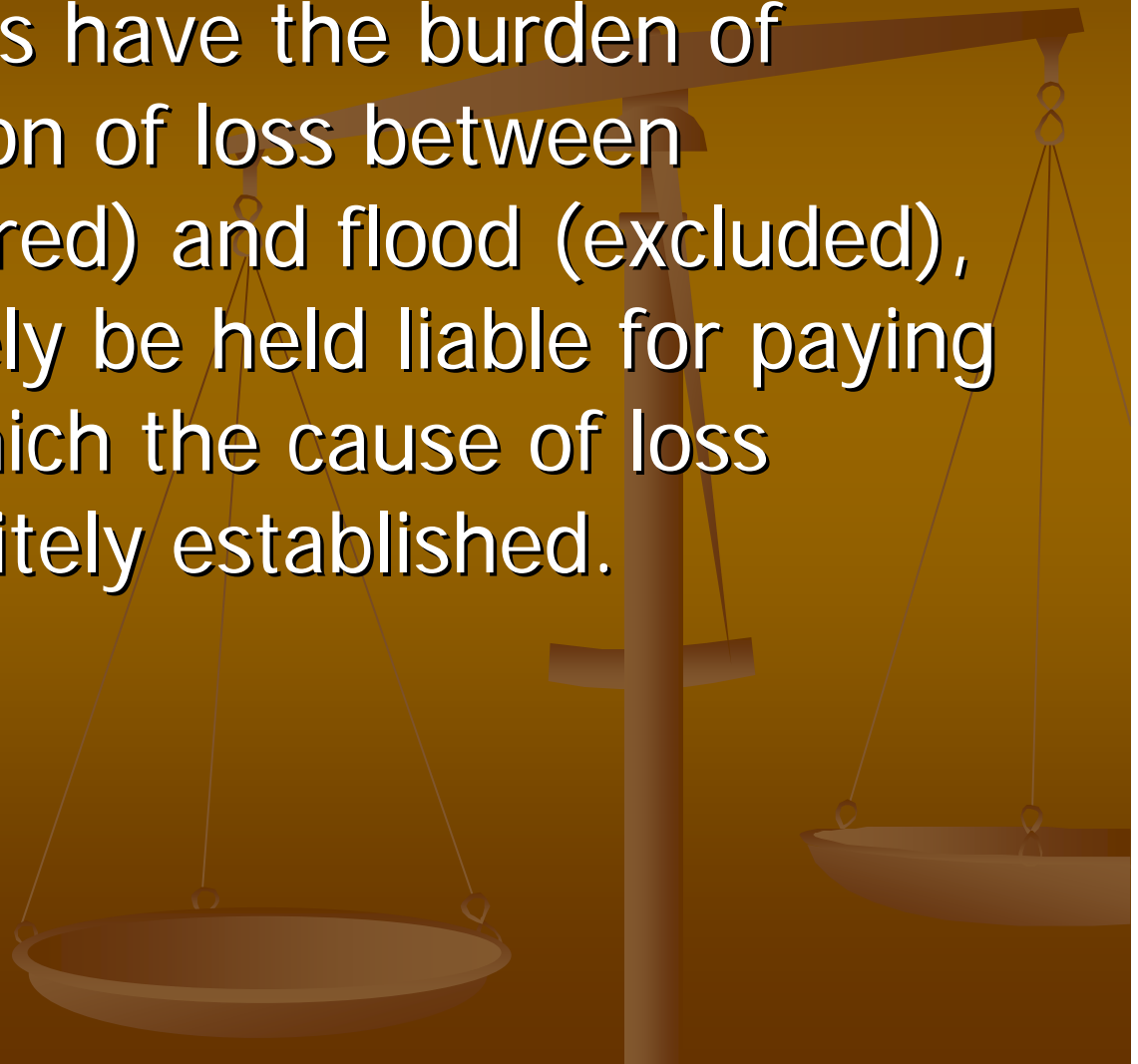
- Efficient proximate cause. Allows payment under the policy if the non-excluded cause is the dominant cause of the loss.
- Concurrent causation. If two causes combine to produce a loss or damage and one of the two causes is excluded and the other is covered, the loss is covered absent wording to the contrary
- In response, insurers developed “anti-causation” provisions.
- Anti-concurrent causation. Excludes from coverage damage that is caused by both a covered peril (wind) and an uncovered peril (water).

Court Interpretations

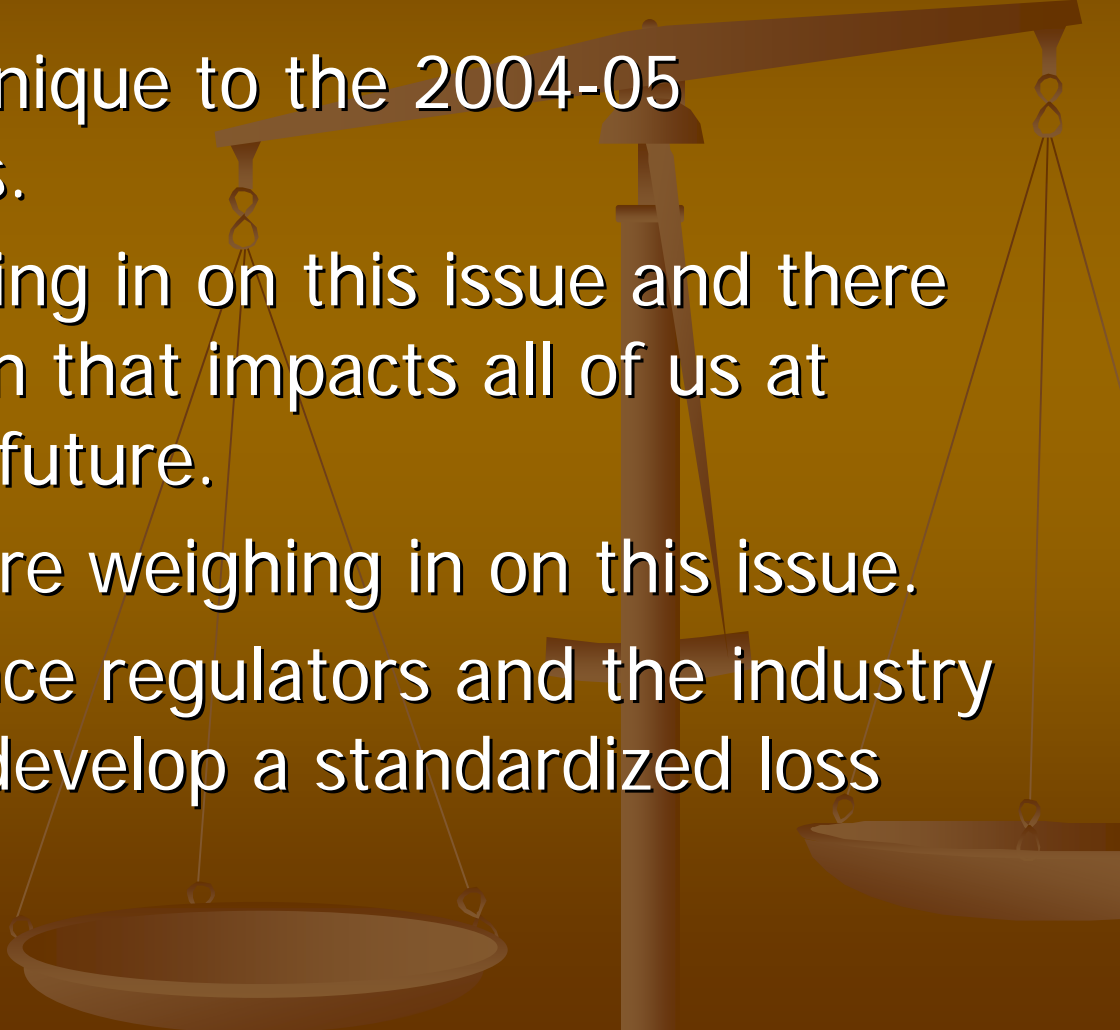
- Some courts interpreted policies to allow policyholders to recover hurricane-related damages if they showed wind was the proximate cause of the loss, even if flooding contributed to the loss. To counter this, insurers have to show that the proximate and efficient cause of the loss was flood, an excluded peril.
- Some federal courts may enforce the exclusion to the extent the damage is caused by flood, not wind and rain, but will not enforce anti-concurrent causation language where it would eliminate coverage for otherwise covered damage.

Note...

- Because insurers have the burden of proving allocation of loss between wind/rain (covered) and flood (excluded), insurers will likely be held liable for paying all losses for which the cause of loss cannot be definitely established.

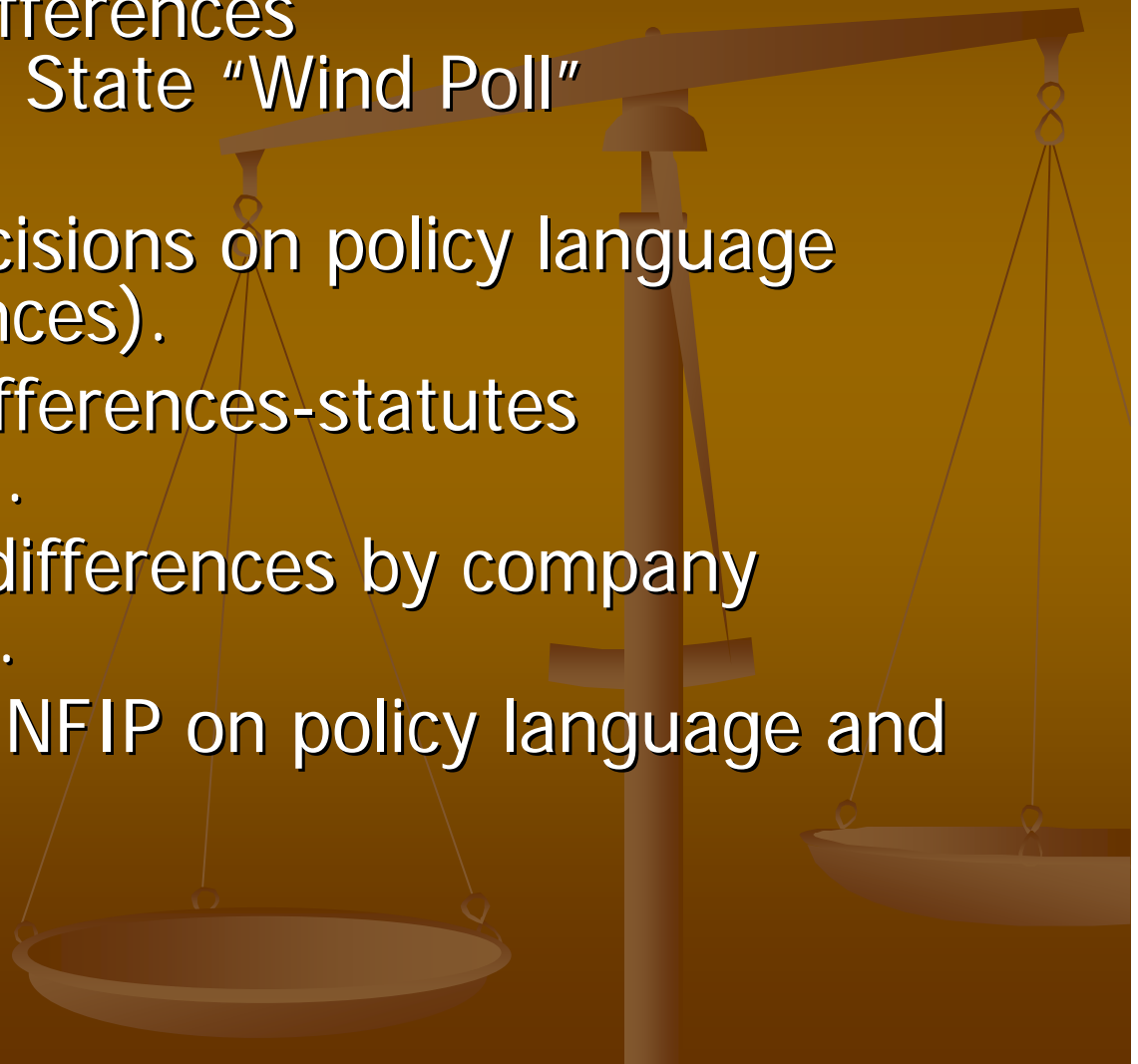


Has the time come for a standardized loss allocation system?

- This issue is not unique to the 2004-05 Hurricane Seasons.
 - Congress is weighing in on this issue and there could be legislation that impacts all of us at some point in the future.
 - Courts have and are weighing in on this issue.
 - Proposal: Insurance regulators and the industry work together to develop a standardized loss allocation system.
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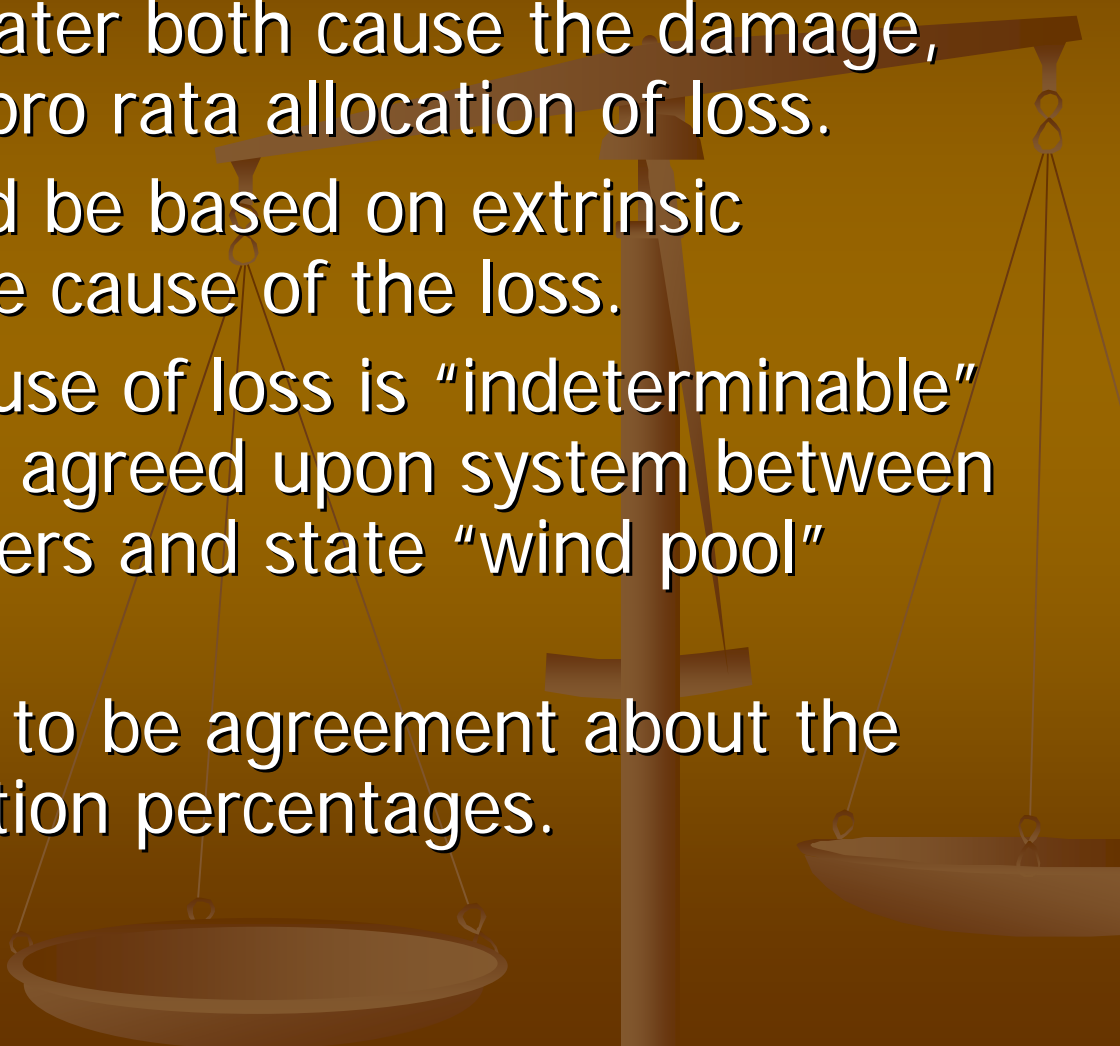
Issues to be addressed

- Policy language differences (NFIP, Carrier and State “Wind Poll” differences).
- Differing court decisions on policy language (State law differences).
- Other state law differences-statutes (state differences).
- Claim settlement differences by company (how trained etc.).
- Coordination with NFIP on policy language and claims.



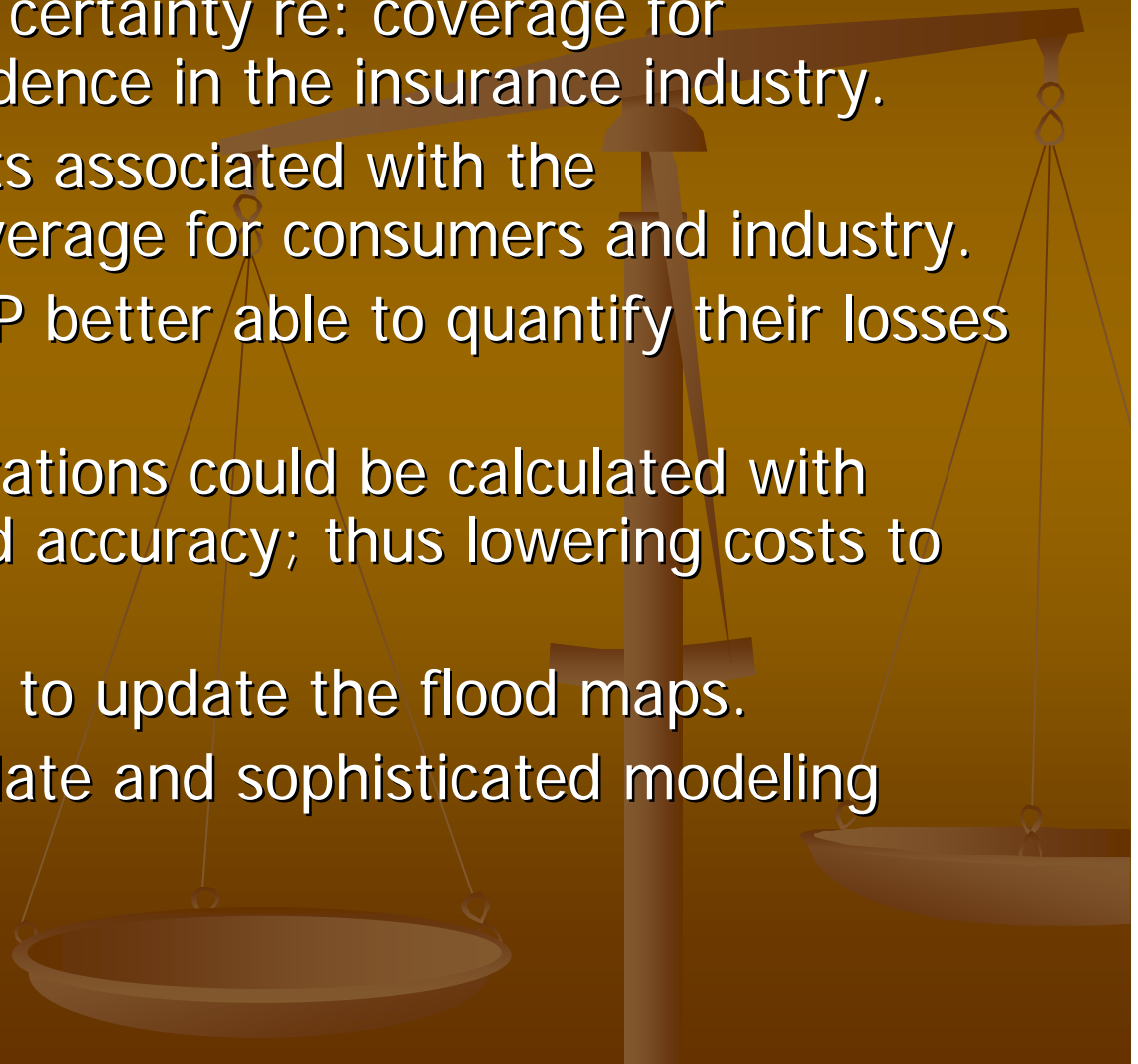
Possible Solution

The Basic Idea

- When wind and water both cause the damage, there would be a pro rata allocation of loss.
 - Contribution would be based on extrinsic evidence about the cause of the loss.
 - However when cause of loss is “indeterminable” there would be an agreed upon system between NFIP, private carriers and state “wind pool” program.
 - There would have to be agreement about the appropriate allocation percentages.
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Win-Win

- There could be more certainty re: coverage for consumers and confidence in the insurance industry.
- Reduce litigation costs associated with the apportionment of coverage for consumers and industry.
- Insurers and the NFIP better able to quantify their losses and price the risk.
- Reinsurance considerations could be calculated with significantly improved accuracy; thus lowering costs to consumers.
- Emphasizes the need to update the flood maps.
- Use the most up-to-date and sophisticated modeling systems.



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