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**Catastrophes – Recent Legal Developments and Implications**

34th ANNUAL GIRO CONVENTION

Celtic Manor

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**Catastrophes – Recent Legal Developments and Implications**

Introduction

- The recent legal developments and in particular the KRW experience
- An update of the current position
- Consider what this means for other actuaries
- Think about the implication for future experience

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**Catastrophes – a review of legal developments**

- A view from the US: Katrina, Rita and Wilma
- The UK summer floods
- The reinsurance implications
- A comparison between the US and UK experience

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## The Katrina, Rita and Wilma litigation

- What has happened to date?
- What is the current position?
- What is still out there?

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## Update on KRW litigation

- Most active litigation in Mississippi
- And, Louisiana
- Not forgetting Florida
- Many cases before the same judges
- “Government” litigation and “policyholder” litigation

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## The issues in the KRW litigation

- Wind damage (generally covered under house-owner policies) vs flood damage (generally excluded and covered separately)
- Burden of proof
- Proximate cause
- Coverage for storm surge
- Concurrent cause policy exclusions
- Bad faith claims handling and punitive damages

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## “Government” litigation

- The Mississippi Attorney General:  
Jim Hood
  - Civil litigation
    - Declaratory relief/injunctive relief
    - State Farm dismissed
    - New lawsuit filed – June 2007



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## “Policyholder” litigation

- Richard (“Dickie”) Scruggs – “A  
Lawyer Like a Hurricane”
  - ✓ Started in asbestos
  - ✓ Tobacco litigation
  - ✓ Lost his home to Katrina –  
but he had flood coverage!



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## Only in America – The Rigsby Sisters

- Former State Farm claims  
handlers
- 15,000 documents were copied  
and given to Jim Hood and The  
Scruggs Katrina Group
- Cori and Kerry now work with  
Dickie Scruggs
- Suits pending for breach of  
confidentiality
- Criminal contempt and  
disqualification motion pending  
against Scruggs



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### Rigsby Documents/The McIntosh Claim

- On 28 September 2005, State Farm paid \$36,000 for wind damage.
  - The dwelling was insured for \$619,600
  - Personal property was insured for \$454,700
- 12 October 2005 report: damage caused by wind.
- On the front of the report is a note stating: "Put in Wind file – DO NOT Pay Bill. Do NOT discuss."
- Second report: damage caused by water.

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### Broussard v State Farm (January 2007) - Mississippi

- Property totally destroyed leaving only concrete "slab" foundation
- State Farm rejected claim
- State Farm's own expert conceded that some wind damage (covered under the policy) had been sustained
- Directed verdict that State Farm had not discharged its duty
- Punitives of \$2.5m, reduced to \$1m

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### Guice v State Farm (March 2007) - Mississippi

- Plaintiff has burden of proving loss covered by policy
- State Farm has burden of proving extent of loss attributable to an excluded peril
- This approach been affirmed by US Appeal Courts in recent decisions

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### Katrina Canal Breaches litigation (August 2007) - Louisiana

- Damage caused by breach of levees
- Insurers argued damage excluded as “flood damage”
- Insureds argued “flood” means natural events
- US Appeals Court for the Fifth Circuit overruled District Court
- Even if levees negligently designed, constructed or maintained, the flood exclusions unambiguously preclude recovery by insureds
- Insureds intend to appeal

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### Leonard v Nationwide (August 2007) - Mississippi

- Dispute with Nationwide over wind vs flood damage
- Nationwide offered \$1,600
- Insured claimed \$47,300 for roof damage
- US Appeals Court for Fifth District
- Overruled District Court and held that concurrent causation clause was not ambiguous
- Upheld that storm surge was excluded by policy’s water damage clause

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### Florida Farm Bureau v Cox (September 2007) - Florida

- Lower court held insurers must pay full claim if a covered peril causes part of a total loss
- Overruled by Florida Supreme Court
- Insurers do not have to pay for excluded or non-covered perils

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## Katrina settlements

- January 2007: State Farm attempts to settle the Mississippi litigation with both the Mississippi AG and Scruggs Law Firm.
- February 2007: Judge Senter rejects the settlement proposal with respect to the individual policyholders.
- March 2007: Scruggs Law Firm "gives up" for the moment and resolves to focus on proceeding with the individual lawsuits.
- March 2007: Mississippi Insurance Commissioner and State Farm enter into an agreement
- Class settlements continue to be denied due to variations among class members
- More settlements likely

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## Recent developments in the Katrina litigation

- State Farm and others settling many cases
- Weiss v Allstate – Allstate settles post trial for undisclosed sum; jury had awarded \$2.8 million including punitive damages
- Federal grand jury investigation in Mississippi
- Qui Tam "whistleblower" suit
- RICO action against State Farm

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## UK summer floods

- No US style spate of litigation
- No issues about flood coverage or meaning of flood?
- May be concurrent cause issues?
- Miss Jay Jay (1987) – more than 1 operative cause: 1 cause covered and 1 cause excluded then exclusion precludes any recovery

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## Reinsurance issues

- Disputes have yet to emerge
- Number of events/occurrences?
- The extent of the obligation to follow the settlements?
- Recovery of ex gratia settlements?
- Hours clause?

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## Comparison of the US and UK experience

- Difficulty of adjusting claims, especially B.I. claims
- Impact of demand surge on costs of repairs
- Litigation in the US has been a product of:
  - the sheer scale of the KRW losses
  - the way that flood cover is written in the US
  - the unique nature of the US legal system

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## What does this mean for actuaries?

- Deeper understanding of claims
- Impact to the reserve estimates
- Impact to forecasts and capital requirements
- Purchase of reinsurance
- Some other thoughts

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## Deeper Understanding of claims

- Enables the actuary to communicate results
  - Better (GN12) reports
  - Potential improvements in technical work (eg better estimates)
  - Help strengthen the link between claims/legal/finance/actuarial
- Improve understanding of variability in results
- Personal interest !

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## Impact on reserve estimates

- Best Estimates
  - Understanding of use of benchmarks
  - Reviewing trends and projecting development of individual catastrophic events
  - Direct vs reinsurance exposures
  - Consideration of reinsurance recoveries
    - Allowance for disputes (both current and future)
  - Reliance on catastrophe modelling

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## Impact on reserve estimates

- Uncertainty
  - Individual court cases introduce one off events which can have significant impacts to an individual insurer (eg Silverstein)
  - Sometimes a judgement could have a significant impact on several claims
  - Uncertainty in reinsurance recoveries
  - All the above increase both parameter risk and process risk – both from known legal issues and the potential of future events
  - Often one of key areas of uncertainty towards end of development of an individual catastrophe

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## Impact on reserve estimates

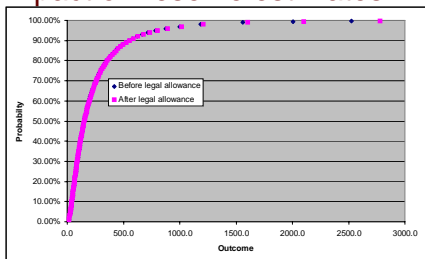
- Estimates of the reserves are potentially highly geared. Consider the following simple example:
  - The estimated reserves for an individual catastrophe are lognormally distributed with mean of 250 gross of reinsurance
  - 750 has already been paid
  - Reinsurance cover was available for 1000 xs 500 (so current net reserves being held are nil)
  - We have then assumed that the potential impact of a legal decision above this is that there is a 10% chance of the future paid claims being 25% higher in any given situation – also assuming that there is some correlation between adverse reserve outcomes and a legal decision becoming adverse

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## Impact on reserve estimates



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## Impact on reserve estimates

- Comments on example
  - The mean increases by 2.5% - but the 99.5% percentile increases by 5% in this example.
  - Demonstrates the potential gearing impact of reinsurance on the net reserve estimate
  - The gearing of the outcomes with the legal decision is particularly noticable in the adverse scenarios (particularly due to assumed correlation between the amounts and the legal decisions)
  - Is this just part of process uncertainty already being modelled? Suggests attempting to remove the impact of these and model separately if possible

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## Impact on reserve estimates

- Comments on example
  - Demonstrates the potential gearing impact of reinsurance on the net reserve estimate
  - Also demonstrates the potentially significant impact of gearing

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## Impact on reserve estimates

- Specific impact on KRW estimates
  - Key area of uncertainty at the moment
  - General recent legal trend has been one of improving for the insurance market but change could occur – be careful with allowance
  - Some of the key areas of litigation impact on a relatively small number of direct insurers with key London market impact being through reinsurance
  - Still large amount of claims remain unresolved => further litigation is possible
  - Possibility does exist for development on claims which appear closed
  - Use of benchmarks and developments for each individual hurricane could still be unstable
  - Development on Energy claims still exposed to litigation/arbitration on wording clauses and coverage disputes
- Impact on the 2004 Atlantic hurricane estimates
  - Appears to be relatively "straight forward" with more "typical" US wind-related exposures
- 2007 UK Floods
  - Development in the UK has led to relatively little litigation – appears to be less significant than in the US
- Terrorist Events of September 11, 2001
  - Litigation still continues to be ongoing

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## Impact to forecasts and capital requirements

- Best Estimates
  - The inclusion of an additional allowance for unexpected litigation impacts within allowance for future catastrophes (ie potentially more than suggested from catastrophe models)
- Uncertainty
  - The areas discussed above relating to the uncertainty of catastrophe events as a result of litigation should be considered in the context of capital requirements (Eg for ICA requirements)
  - The capital requirements both relates to existing known catastrophes and those relating to future events
  - Use of historical experience (particularly Katrina and WTC) suggest that an allowance should be factored in to catastrophe modelling allowance – do you allow for this in your catastrophe modelling?

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## Purchase of Reinsurance

- Requirements
  - The additional uncertainty created by potential litigation and unexpected losses could impact a purchaser's reinsurance requirements
  - When purchasing Original Loss Warranties what impact could litigation on claims make?
- Wording
  - As experience occurs and new litigation developments with new events this can lead to changes in wordings (both direct and reinsurance) – what lessons are there from the Katrina experience?

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## Use of knowledge for other calculations

- Uncertainty
  - Individual court cases introduce one off events which can have significant impacts to an individual insurer (eg Silverstein)

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## Some other thoughts

- The recent experience has involved surprises from developments on KRW – what next?
  - Quake?
  - Large mega-losses across Europe?
- Liability catastrophes
- Sources of information

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# Questions and Discussion

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