



## **CFA Comments on Flood Insurance Discussion Draft**

The House Financial Services Committee Discussion Draft flood insurance bill is an improvement over previous drafts but still has some very bad provisions. Here are some thoughts on specific provisions of the draft bill:

- The affordability provision, where the states determine affordability problems and submit the list of properties with such problems, is a good idea. The spreading of the cost of lowered program premiums to all policies in the state makes sense.
- Allowing commercial properties to opt out of coverage is a good idea. But properties opting out should be barred from receiving disaster relief for the amounts they should have insured.
- Clear communication of the flood risk is important and a good idea.
- Allowing greater private insurer participation is a good idea but there are problems with the approach in this draft legislation. First, the policy issued by private insurers does not have to be at least equal or equivalent to the NFIP coverage. Thus, sharp dealing companies could sell policies for 75% of the NFIP premium while lowering the coverage provided to 50% of that covered by NFIP policies, gaining market share but leaving homeowners underinsured and taxpayers at risk. Second, surplus lines carriers are allowed to write. I have written previously on the myriad problems with that (see below).
- Private competition and the removal of the Write Your Own (“WYO”) NFIP servicing company non-compete clause, can destroy spread of risk for the NFIP as insurers cherry-pick the best risks and leave the riskier properties with NFIP. Regulators certainly understand the danger to economic viability of an insurer from adverse selection. Insurers would target customers with “overpriced” policies (and because of reserve rules currently imposed by Congress there will be many of these) that take into account the need of the NFIP to fairly price policies for everyone and also cover past losses. The NFIP then would increasingly be left with the highest risk policies, increasing the need for federal subsidies and/or higher NFIP prices to cover losses for a higher risk portfolio of properties. If prices were raised to make up for this shortfall, that would open the door for even greater cherry picking by the private insurers, creating a death spiral of higher losses and premium charges for the NFIP.
- The draft legislation appears to remove the 45-day notice of cancellation to consumers, which would allow private flood insurers to cancel a policy at will, either immediately or with very short notice. This, coupled with the fact that the NFIP does not offer coverage until after 30 days have passed since application, presents a real concern that consumers in flood prone areas could be made

uninsurable for a month at the whim of their surplus lines insurer, perhaps in advance of an approaching storm. A regulated private insurer would presumably not be able to get away with placing short notice provisions in its regulated policy form if you, the state regulators, are doing their job. But, as noted above, regulators are helpless in the case of surplus lines insurers since policy language is not regulated by the states for surplus lines carriers.

- Limiting WYO expenses to 25% of the premium is a good step toward eliminating the excessive WYO profits that have been well-documented in recent years.
- Encouraging states to create all-risk policies by allowing them to meet the program's mandatory purchase requirement is a good idea.

### Problems with Surplus Lines

We support greater involvement of private insurers in the NFIP, but the draft's accession to the surplus lines approach proffered by HR 2901 is dangerous to consumers. This proposal poses many risks to consumers by allowing surplus lines carriers into the flood insurance market.

The draft legislation would allow surplus lines insurers to enter this market and possibly gain significant market share. However, these insurers are not regulated by the states in any meaningful way. Unlike consumers with auto or homeowner claim or other complaints who can seek a remedy from their state insurance department, consumers with flood insurance through a surplus lines insurer would be unable to seek effective assistance from their state since surplus lines carriers' claims and other practices are not regulated by the states. We remember, for example, that after the 1992 Los Angeles riots, surplus lines insurers not only went bankrupt but some simply walked away from claims, leaving many small businesses without coverage and forced into bankruptcy. The California Insurance Department reported that, in the wake of that event, one-quarter of small businesses, many of them minority-owned, were unable to reopen because of this surplus lines debacle.

Under the draft legislation, consumers would find themselves buying private market policies for which they receive virtually no protections from state insurance departments. State regulators cannot help a consumer of a surplus lines carrier who denies or delays payment on a legitimate flood claim. The states cannot make sure rates are not excessive, inadequate or unfairly discriminatory like they do in other lines of property/casualty insurance. If a surplus lines insurer sells policies with very low coverage at clearly excessive prices, insurance departments are handcuffed. As a former Texas Insurance Commissioner I can attest, that state regulation of forms frequently finds and removes misleading, unclear, unfair, illegal, and ambiguous clauses from policies prior to their use. That option is not available for the surplus lines policies that would ostensibly compete with NFIP. Presumably, legislation could be written to authorize more comprehensive state regulation of surplus lines, but this draft does nothing of the sort, and we know of no such legislation moving in the states.

A second serious problem from the policyholder viewpoint is that if a surplus lines insurer goes bankrupt, the consumer has no access to any state guarantee fund that

pays claims in the event of an insurer's insolvency. How is a consumer to know about that or appreciate the true cost of taking that risk?

In short, the draft legislation should remove any and every provision that would allow flood policies to be sold by surplus lines carriers.

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