July 18, 2017

Senator Mike Crapo
Chair
U.S. Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Senator Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Re: Principles for National Flood Insurance Program (NFIP) Reauthorization

Dear Chairman Crapo, Ranking Member Brown and Members of the Committee,

I write this letter on behalf of Consumer Federation of America (CFA) where I am the Director of Insurance. I was the Federal Insurance Administrator under Presidents Ford and Carter. In those positions, I helped to create and run the NFIP in the 1970s. I have also served as Texas Insurance Commissioner.

I have been involved with flood insurance since I ran the Program. Last year I worked on and participated in PBS's ("Frontline") and NPR's ("All Things Considered") extensive reporting on the NFIP for a report entitled "Business of Disaster" (May 24, 2016).

CFA strongly supports Congress taking steps during this reauthorization process to allow private insurers to assume a significant amount of flood risk. However, involving the private insurance market on flood insurance requires careful planning since some proposals we have seen would expose consumers to extremely unfair practices and expose taxpayers to more risk for reasons we explain in this letter. Any increase in the role of private insurers must be accompanied with robust consumer protections.

Since the development of a private flood insurance market is the most important proposal before Congress during this reauthorization process, this letter will focus on just the issues involved with that action. There are many other proposals to change the flood insurance program, some of which we heartily support, such as steps to assure affordable flood insurance to low- and moderate-income policyholders, and some ideas that we strongly oppose. The Appendix[1] to this letter goes through these proposals and specifically provides comments on S. 563 and S. 1368.

Achieving a Strong Private Flood Insurance Market While Avoiding Consumer and

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[1] http://consumerfed.org/wp-content/uploads/2017/07/appendix-to-principles-for-national-flood-insurance-program-reauthorization.pdf

Taxpayer Dangers

We believe that the focus of Congress in developing a private flood insurance market should be a plan that will, over the coming decades, achieve the long-term goal of ultimately having private insurers include flood insurance in their homeowners insurance policies as a standard coverage with mapping, mitigation, land-use control, and possibly some reinsurance backup for extreme events being the only remaining roles for the federal government. The transition to this fully private flood insurance program will take many years but every step to achieve this vision must be done carefully, making sure that the changes do not make the situation worse for taxpayers and consumers (for instance by undermining the spread of risk in the NFIP and assuring that the private coverage is as complete as the NFIP to avoid increases in disaster relief). Congress must also make sure that the changes protect people who live in high-risk flood plains and who are forced to purchase flood insurance from abusive and unfair insurance scams.

Critical questions that must be answered as Congress considers how to encourage private insurers to take some, and ultimately all, of the existing flood risk covered by the program are: how the insurance part of the federal program could be phased out to spur more private risk taking; how low- and moderate-income homeowners and renters could be protected from rate shock and provided with a targeted subsidy to help them afford flood insurance while moving to fully actuarial prices in order to facilitate private insurer involvement and, what requirements should be kept in place and further improved regarding flood maps, mitigation and construction in local communities. Congress should review how to move the regulation of the insurance aspects of the program (not the mapping, mitigation and other aspects appropriate for federal control) from FEMA to the states. The National Association of Insurance Commissioners (NAIC), therefore, has an important role to play in developing regulatory model laws as a new, more private flood insurance system emerges.

The Consumer Interest in Fixing the NFIP

CFA is often asked how a consumer group can favor moving the NFIP toward private insurance control and, thus, toward actuarial soundness, which will raise rates for some consumers. CFA strongly believes that both the program and the private market should set fair, actuarially sound rates that accurately reflect the potential loss risk (so long as Congress develops an explicit and targeted subsidy program for lower-income Americans written in the program as these higher rates are applied). Further, we believe sound pricing is critical in order to accurately signal to prospective homeowners and builders the dangers associated with developing areas of communities with high flood risk. Congress must act to make the true cost of flood insurance known to home buyers, even if they receive a subsidy, so they know the risk they are placing on their families and possessions.

Homeowners who buy new homes in areas that they think are safe from floods are harmed when old maps underestimate risk. Some are misled into believing their homes are safe from floods when they build or buy new homes built to the old map's 100-year flood estimates that are, in fact, far below the real 100-year elevation. These people and their families are at risk of being killed or injured if a storm hits, or of having their homes or treasured possessions destroyed. Facing higher premiums and being truly aware of the risk associated with this dangerous development is a blessing, not a curse, for these consumers and prospective residents.

Other homeowners will look at these inaccurate flood maps and think, “I don’t need insurance, I am way outside the risk area.” But they may in fact be well inside the area of high risk when the maps are old and development, erosion, climate change and other impacts have caused the 100-year flood to rise significantly, as those living on the Gulf found out the hard way during Hurricane Katrina. CFA’s study of Hancock County Mississippi flood maps after Hurricane Katrina hit found that the average map (of 76 in the county) was 20 years old and 10 feet too low in measuring the 100-year flood elevation.[2] Many home and business owners were misled into building unwisely, or not buying needed insurance, in the county where Hurricane Katrina hit, exposing the deeply flawed program’s weaknesses in a most tragic way.

Targeted subsidies should be used to help low- and moderate-income people in flood-prone areas who cannot afford flood insurance. Just as it is improper for states to require auto insurance but then fail to ensure that lower-income good drivers can afford it, is improper for the federal government to require the purchase of flood insurance, as the NFIP does, and not help those who own reasonably safe structures but cannot afford the coverage. Those smart subsidies notwithstanding, it is improper to give broad, hidden subsidies to consumers and call such offerings “insurance.” Targeted subsidies for those who are most in need would cost far less than the current mix of general subsidies, some of which appear not to have been authorized by Congress.

Ways to Allow Private Insurance Markets to Develop While Minimizing Consumer and Taxpayer Risk

CFA has contemplated ways to allow private insurers into the flood insurance market that would greatly minimize the problems discussed above, and we would be pleased to participate in a process for further development of these ideas. As an introduction to our thinking, a starting place for the transition to a private flood insurance market might be FEMA negotiating with the Write Your Own companies for the WYO’s to take a small percentage of the risk of the actuarially rated policies they insure. They would then have an incentive to help ensure that the NFIP’s actuarial rates are based on actual risk and not outdated flood maps or other factors that have undermined actuarial pricing in NFIP. Over time, the risk these insurers bear could be gradually raised as the companies gained experience, increasingly allowing the federal government to play less and less of an insurance role and more of a mitigation role as well as a reinsurance role in the event of a major catastrophe. As the insurers write more of the risk, there will be an appropriate time to allow the insurers to compete with each other for the flood insurance business as part of their homeowners insurance contracts with the federal role reduced to a reinsurer of private flood carriers. State regulators should be asked by Congress to partner with FEMA to determine, as this new program of private involvement grew, when various aspects of the insurance regulation of the program could be shifted over to the states.

State Insurance Regulators Must Establish Laws to Protect Consumers Prior to Expansion of

[2] “An Examination of the National Flood Insurance Program,” testimony of J. Robert Hunter, Director of Insurance, CFA before the Committee on Banking, Housing and Urban Affairs of the U. S. Senate, October 2, 2007. http://consumerfed.org/_archives/elements/www.consumerfed.org/file/finance/Hunter_Testimony_Insurance_Reform_10-30-07.pdf

Private Insurance Market Involvement

State architecture of private flood insurance market has not yet been established and is necessary to ensure that consumers and taxpayers are protected during this change in the marketplace. Any bill should require that, as the NFIP moves toward more private sector involvement and the migration of regulation moves back to the states, that state architecture is developed and must address critical components of the transition. Such architecture should include regulations to prevent a loss of consumer protections during the transition, address solvency in high-risk flood markets, and include controls on unfair methods of competition such as unfair policy language, as well as other consumer protections.

Turning the Market over to Surplus Lines Carriers to Increase Private Insurance Involvement is Dangerous to Both Consumers and Taxpayers

We support greater involvement of private insurers in the NFIP, but some of the drafts allow unregulated surplus lines insurers to write flood insurance. There are many risks to consumers from any proposal to allow surplus lines carriers into the flood insurance market.

Surplus lines insurers are not regulated by the states in any meaningful way. Unlike consumers with auto or homeowner claims 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. These small businesses were then forced into bankruptcy. The California Department of Insurance 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.

Consumers would receive virtually no protections from state insurance departments if a surplus lines carrier 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. If low levels of coverage are sold by surplus lines insurers – for example, policies with high deductibles or various exclusions built into the policies – the states could not remedy that and that would expose taxpayers to significant increases in disaster relief payments to fill the coverage gaps.

Another problem with the ability of surplus lines carriers to write low coverage flood insurance policies is the unfair competition that would develop both to competing private insurers and the NFIP. A surplus lines insurer that, for instance, crafts a policy with 50 percent of the coverage removed by exclusion, could sell that policy for, say, 60 percent of the NFIP rate, making a huge profit while exposing taxpayers to greater risk. This is the worst kind of cherry-picking, in which an insurer deceptively acquires the best risks – exposing those homeowners to insufficient coverage after a disaster – and leaves the riskiest properties to the NFIP – exposing those homeowners to a spiral of higher premiums (and taxpayers to ever-increasing subsidy costs).

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? To imagine how profound this lack of guarantee would be, just imagine if a small surplus lines carrier had grabbed a bunch of market share in Baton Rouge and was now overcommitted where there were at least 140,000 homes damaged by the disastrous flooding of 2016. This also increases the taxpayer exposure.

The legislative proposals that allow surplus line carriers to offer flood insurance would put consumers at risk in several other ways as well, including:

If a surplus lines insurer wrote ambiguous or even clearly misleading policy language there is no way for a state or FEMA to prevent or clarify its implementation. As 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 surplus lines policies sold in the Unites States today. Presumably, legislation could be written to authorize more comprehensive state regulation of surplus lines, but that is unlikely to be undertaken by Congress under McCarran-Ferguson Act conditions.

Congress could fix some of these problems by requiring all private insurers to offer coverage at least as strong as the NFIP.

A related problem comes, as noted above, with the inevitable cherry picking against the NFIP that these surplus lines carriers would conduct. Congress should 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.

It is vital that Congress require private insurers to have at least a 45-day notice of cancellation to consumers. If Congress does not do that, then surplus lines and other private flood insurers could 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 the state regulators are effectively monitoring forms filed with the states. But regulators are helpless in the case of surplus lines insurers since policy language is not regulated by the states for surplus lines carriers.

Prevent WYO Companies from “Cherry Picking” Risks before Removing Non-Compete Rules

Allowing WYO companies to compete for policies could benefit the overall market so long as these insurers are participating in the full market and not just cherry picking the lowest risk properties. If the WYOs are unfairly selling to only extremely low risks it will leave the NFIP in a death spiral of having to raise rates due to adverse selection, which would further weaken NFIP without strengthening the overall protection of homes in flood prone areas. The non-compete clause in WYO contracts should only be removed when standards are in place to protect against "cherry picking." It would be very inappropriate for FEMA to pay WYO companies to collect and store data that could then be used against NFIP to select out only the very lowest risks and undermine the NFIP. An example of a requirement that might help lower the adverse selection problem for the NFIP could be that risks taken out of NFIP by a private insurer meet a test of percentage take-outs being similar across risk zones and not just in low-risk areas.

Private Insurers Should be Required to Collect the Same Surcharges as NFIP Uses

CFA strongly supports a provision that treats private policies the same as NFIP policies with respect to surcharges. It is absolutely vital that the private carriers collect the fees needed to help fund mapping (without which the private rates could not be made) and mitigation activities (which are important for risk reduction purposes). They should also help pay down the debt if surcharges are used to do that. To not require the same surcharges creates unfair competition in the flood insurance market and undermines the long-term viability of the mapping/mitigation/taxpayer protection goals of Congress.

The Danger of Allowing Private Insurance to Count as "Continuous Coverage"

Continuous coverage opens the taxpayer to high risk. If a private insurer writes a lot of low coverage policies in, for example, Key West, and a storm is approaching, can the private sector insurer cancel immediately and NFIP must offer continuous (presumably full) coverage? Congress should do two things if a continuous coverage rule is to work while protecting abuse. Congress should keep the 45-day cancellation requirement and should require private coverage, including by surplus lines insures, to be equal to NFIP coverage.

Conclusion

CFA requests that Congress carefully consider our comments in this letter and the Appendix, which we have crafted to assist you achieve greater private sector participation with protection of consumers and taxpayers. We trust that our ideas will help Congress avoid several serious problems that some of the draft bills we have reviewed would create. We stand ready to work with you in any way that helps you achieve these important goals.

Sincerely,

J. Robert Hunter

J. Robert Hunter
Director of Insurance

CC: Members of the U.S. Senate Committee on Banking, Housing and Urban Affairs