Consumer Federation of America

November 7, 2017

OPPOSE H. R. 2874, THE 21ST CENTURY FLOOD REFORM ACT

Dear Representative,

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 National Flood Insurance Program (NFIP or Program) 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, for example, 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. H. R. 2874 would expose consumers to unfair insurance 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. Therefore, we strongly oppose H.R. 2874.

Since the development of a private flood insurance market is the most important proposal before Congress during this NFIP reauthorization process, this letter focuses first and foremost on the issues involved with that action. Later in the letter we will briefly discuss a few of the other key ideas in the bill, 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.

SECTION 1 – INCREASING PRIVATE INSURER INVOLVEMENT IN WRITING FLOOD INSURANCE

Achieving a Strong Private Flood Insurance Market While Avoiding Consumer and 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. H. R. 2874 fails to protect consumers from these potential dangers.

H. R. 2874 Allows Surplus Lines Carriers to Write Flood Insurance – A Step that is Dangerous to Both Consumers and Taxpayers

While we support greater involvement of private insurers in the NFIP, allowing unregulated surplus lines insurers to write flood insurance is dangerous. 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, 80 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 achieved a large market share in Houston and was now unable to pay claims from Hurricane Harvey. This, obviously, also increases the taxpayer exposure.

By allowing surplus line carriers to offer flood insurance, H. R. 2874 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 this bill does not do that.

A related problem comes from the inevitable cherry picking against the NFIP that these surplus lines carriers would conduct. Congress should understand the danger to economic viability of any insurer, including the NFIP, 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 greater 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.

Section 203 of H. R. 2874 Allows Write Your Own (WYO) Companies to "Cherry Pick" Risks by Removing the 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. To minimize r the adverse selection problem for the NFIP, risks should be taken out of NFIP by a private insurer and meet a test of percentage take-outs being similar across risk zones and not just in low-flood-risk areas.

Private Insurers Should be Required to Collect the Same Surcharges as NFIP Uses. H. R. 2874 does not do this.

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.

H. R. 2874 Allows Private Insurance to Count as "Continuous Coverage," which Poses High Risk to Consumers

Continuous coverage opens the taxpayer to high risk. For one thing, it would allow a consumer enjoying a low grandfathered rate to leave the program and return, perhaps years later, and get to reclaim that low, subsidized rate. This is abusive to taxpayers. Further, if a private insurer writes a lot of low coverage policies in, for example, Key West, and a storm is approaching, could the private sector insurer cancel a policy with much less coverage and the NFIP have to offer (presumably full) coverage as if the policy had always been in the Program?

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 WYO 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 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, state architecture be developed to 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, claims appeals and other consumer protections normally in place in the states to protect consumers of property/casualty insurance.

SECTION 2 – OTHER KEY ISSUES OF CONCERN IN H. R. 2874

H. R. 2874 Does a Good Thing by Creating a Targeted Subsidy Program for Lower-Income Americans but Requires Additional Improvements.

Section 103 of the bill has a plan to target lower-income Americans with subsidies. This allows elimination of all other subsidies. H. R. 2874 should be amended to remove all other subsidies, particularly grandfathering and pre-Firm subsidies. The savings from removing these subsidies would more than pay for the targeted subsidies for the poor. These subsidies should be paid by Congressional Authorization and not by the method proposed in H. R. 2874, which sets up a state-based plan that will drive up premiums to above actuarial levels on those consumers not qualifying for the low-income subsidy. The H. R. 2874 method sets up a tension between the rich and the poor in every state that will result in unequal protection of consumers forced to buy flood insurance by the federal government. This inappropriate funding methodology should be removed from the bill.

Section 102, Limits on Premium Increases, allows prices to move toward the actuarial level at a rate of 15 percent a year. This cap is unnecessary, or could be much higher, since the targeted subsidy for the poor protects the poor and those who are not poor should be promptly moved to full actuarial rates not only to keep down taxpayer costs but to allow private insurers to compete on a level playing ground with the NFIP on all risks.

Grandfathering should be ended. Grandfathering is a key reason for rate inadequacy in the NFIP and this approach to subsidies should not be allowed to continue, particularly given the introduction of a subsidy to assure affordability for the poor (Section 103). The practice of grandfathering flood policies undermines affordability of flood insurance, as it requires higher overall rates to make up for the grandfathering shortfall. Grandfathering should not be allowed in cases of simple map updates reflecting changed conditions that are expected such as increase in flood levels from new construction or climate change. The current system of paying for the shortfall in premiums due to grandfathering by cross-subsidy from other NFIP policyholders cannot stand if private insurers are writing flood insurance. The overpriced NFIP policies are easy targets for "cherry-picking" by the private market, leaving the cost of underpriced policies to be borne by taxpayers.

Title III, Mapping Fairness, is excessively restrictive on FEMA's ability to get new maps into place in communities so that new structures are built wisely and full actuarial rates can be charged to structures in high-risk flood plains. This Title seems intended to slow implementation of new maps, allowing appeals on all kinds of questionable things such as "ditches," "vegetation" and other such claims. And, if that appeal is rejected, another appeal to a "Scientific Resolution" panel follows, giving equal weight to a scientific map and a claim of some ditch changing it. Owners can appeal to the local government for relief. Communities are allowed to develop competing "alternative" maps rather than just trying to improve the FIRM being used or proposed. It seems to be a deliberate administrative nightmare for FEMA, intended to delay progress in getting up-to-date maps in place in a community. This increases impediments to an already too slow process.

Section 507 allows WYOs to continue to collect excessive costs for selling and servicing NFIP policies. A cap on the allowance for WYO insurers of 29.7 percent to service the flood policies is too high. It should be no more than 20 percent. The bill also does nothing to control the excessive claims handling fees the WYO companies enjoy.

Sections 508 and 514, dealing with market penetration failure, are excellent steps to determine why the NFIP's market penetration is so weak (only 15 percent of Houston flood damage from Harvey was covered by NFIP policies) and begin to take steps to fix whatever causes this problem.

Section 512, private reinsurance, requires FEMA to purchase private reinsurance. It is totally inappropriate for Congress to make a market for an already rich worldwide private reinsurance industry. This section must be removed from the bill. The idea of having the NFIP buy reinsurance from private reinsurers will cost taxpayers significantly, about 50 percent more in dollars on the amounts reinsured than if these private reinsurers were not involved. Obviously, reinsurers will not offer their protection unless they make money doing so. These reinsurers will, over time, require overhead costs and profit amounting to at least one-third of the premium. That translates into a rate increase of at least 50 percent (1 / [1 – 0.333]). Theoretically, a reinsurer should be the largest source of capital present in the market. A small insurer goes to a large reinsurer or groups of reinsurers for cover. The U.S. federal taxpayer base is huge, dwarfing even a combination of all reinsurers in the world. NFIP does not need to go to this much smaller financial base of private reinsurance for protection. The idea of private reinsurance backing up the federal taxpayer is the reverse of the normal, logical reinsurance arrangement. Private insurance needs to be at the bottom layers of the risk, not the top levels. Ultimately, as we work toward more of a private sector role, the private insurers should be taking the low levels of risk, starting with the first dollar of claims, and the government's role should become the reinsurer of very large events, perhaps, if cost- effective, with private reinsurers taking an intermediate layer of risk.

Title VI, administrative reforms, contains several very helpful consumer protections, including enhanced appeal rights on claims, access for policyholders to engineering and other technical reports vis-à-vis their claims and improved/simplified disclosure of what is in the BFIP policy.

Conclusion

CFA requests that Congress reject H. R. 2874 and carefully consider our comments in this letter. Since we believe in expanding the NFIP to allow more private insurance underwriting, we would welcome the opportunity to assist you achieve greater private sector participation with strong protection of consumers and taxpayers.

Sincerely,

J. Robert Hunter

J. Robert Hunter Director of Insurance

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