July 20, 2018

Jennifer Hammer, Chair
Property & Casualty (C) Committee
National Association of Insurance Commissioners
Via email c/o Aaron Brandenburg

Dear Commissioner Hammer:

The U.S. Congress is considering, and state regulators have supported, an increased role for the private sector in the flood insurance marketplace. For many years, the National Flood Insurance Program has provided almost all residential and small-business flood insurance coverage and, therefore, state regulation has been minimal.

The Flood Insurance Work Group of the American Academy of Actuaries[1] last year issued a monograph, *The National Flood Insurance Program: Challenges and Solutions*. Amid the growing consideration of a private flood insurance market, we are following up our monograph with a review of questions that may arise as an expanded role for the private sector is contemplated.

The accompanying document, *Flood Insurance Private Coverage: Questions for Regulators*, is for your review and intended to aid in anticipating issues that may arise in the event the flood insurance market transitions from mostly federally provided coverage to an increased share being state-regulated private coverage.

We look forward to working with the NAIC and individual insurance departments as they address these issues. For more information, contact Marc Rosenberg, the Academy's senior casualty policy analyst, at rosenberg@actuary.org or (202) 785-7865.

Sincerely,

Kay Cleary, MAAA, FCAS
Chairperson
Extreme Events & Property Lines Committee

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[1] The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policy makers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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Flood Insurance Private Coverage:

Questions for Regulators

American Academy of Actuaries

Extreme Events and Property Lines Committee

July 2018

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Special thanks to Stuart Mathewson, Patrick Causgrove, Stacey Gotham, and Stephen Kolk

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I Purpose and Scope

A Expanding the role of the private insurance market in providing flood insurance coverage to homeowners, renters, and small businesses has been discussed by decision makers at both the federal and state levels. While the Academy takes no position on the issue of whether private insurance, public insurance, or some combination is best for consumers and taxpayers, the U.S. House of Representatives passed legislation in 2016 (HR 2901) and again in 2017 (HR 2874) to encourage growth of the private flood insurance market; similar legislative proposals are pending in the Senate. The administration has also called for an expansion of the private market for flood insurance. In addition, state regulators have endorsed a greater role for the private market.

B Flood coverage traditionally has been written by the National Flood Insurance Program (NFIP), which is exempt from many state regulations. If the private sector assumes a bigger role in flood coverage, many issues will need to be addressed. This document discusses the issues that may arise from flood insurance being provided more widely by private insurers in accordance with the pending federal legislation.

C While the issue of private-market flood insurance has been discussed for quite a while, it appears that the topic is gaining more traction. Pending legislative changes, such a change will bring a significant shift from the single federal agency to multiple state regulators. The changes could be complicated, requiring complex responses. The shift from federal to state regulations or a combination thereof, leads to a question of how the change from a single agency NFIP to a multimarket, multistate policy program will be managed. Will the change be abrupt, or will gradual adjustments take place over time?

II Issues

A Market Issues

New legislation could significantly expand the role of the private market in offering flood insurance. If this happens, questions arise regarding the interaction between the NFIP and the private market under the proposed legislation. Following are potential questions:

- As a result of the federal law creating the NFIP, it is exempt from some requirements and potential legal issues. For example, there is currently state-level debate about the use of Assignment of Benefits (AOB). How is the state level conversation on AOB likely to change for private-market coverage, and what might the consequences be? Will companies need to enhance their rates or consider additional exclusions to deal with coverage, settlement, or other issues such as these?

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- Most of the large losses the NFIP has seen are due to hurricane flooding, because coastal flood risk is correlated with hurricane wind risk. How much private insurance capacity will be available for flood insurance, especially in hurricane-prone areas? How will companies that currently sell homeowners coverage in hurricane-risk states act if they are already stretched in their allowable capacities for these areas?
- Will private insurers be more likely to concentrate flood writings in inland regions, leaving the coastal areas to the NFIP?
- Will companies maintain their presence if they experience poor results? If they don't, what will happen to policyholders in those areas?
- If the private market increases significantly, will this leave the NFIP with a smaller number of risks—those which are underpriced—resulting in premium income that may be inadequate to cover even normal losses?
- What requirements, if any, will apply to policyholders who switch between federal and private flood insurance coverage? If private insurers raise rates or withdraw coverage, will policyholders be able to get back into the NFIP, and at what price?
- Surcharges on NFIP policies currently provide a significant portion of the funding for the flood mapping program. Will a system be developed for maintaining the Federal Emergency Management Agency's (FEMA's) funding of valuable activities such as mapping?
- There are surcharges on NFIP polices to help repay borrowings during past catastrophes. If these surcharges do not apply to private-sector flood insurance policies, does this create artificial price disparities and issues of equity between NFIP and private policies?

B Contract and Coverages

The NFIP contract has, for dwelling policies, a maximum limit of $250,000 for residential buildings and $100,000 for contents. For commercial policies, the NFIP maximum limits are $500,000 and $500,000. The NFIP limits coverage for valuables such as art. Additionally, the NFIP coverage for contents is at actual cash value for personal property and typically does not include other additional coverages. There are some questions that will arise about additional coverage that may be available in the private market as compared to current NFIP policies:

- Private-sector policies cover higher limits than the NFIP for other perils on residential and commercial policies. Will the private-sector policies include these same higher limits for flood coverage?
- Will private-sector policies include Additional Living Expense coverage for the flood peril?
- Will private-sector policies allow for replacement cost coverage for personal property?
- Will private-sector policies include higher limits for valuables?
- Will private-sector policies provide coverage for items such as pools, hot tubs, decks, fences, landscaping, and basements?
- Will private-sector policies allow for Business Interruption coverage on commercial policies?

- Will coverage be added as an endorsement to a property policy, or will it be sold as an additional policy?
- If determination of peril is important for coverage and limit determination, will the private sector continue to use the current process of determining flood versus other perils, or will it make changes to the current processes?
- Will private markets use the same deductibles as the NFIP, or individualize them to coordinate with an underlying property policy? Will there be required deductible offerings?
- Will there be the same rules for stand-alone policies vs. endorsements?

C Underwriting

Given the catastrophic nature of flood insurance, private insurers may have the potential for increased volatility of earnings, capital-damaging occurrences, and even solvency risk. Private-sector companies have various underwriting requirements that help manage financial risks from catastrophic events like hurricanes and earthquakes. Due to the potential risk, questions arise regarding the underwriting of flood risk:

- What geographic flood risks will the private sector accept?
- Will other characteristics, such as credit or other consumer information, be used within the underwriting evaluation?
- What will the non-renewal requirements be for private-sector companies?
- What policyholder characteristics will be used for private-company non-renewals?
- Will non-renewal requirements differ based on whether the flood coverage is sold as a separate policy as opposed to an endorsement to a property policy?
- If sold as a separate policy, will other personal lines coverage (auto, home, etc.) be mandated to be purchased before flood insurance can be purchased?
- What type and magnitude of deductibles will be permissible?

D Rates

The flood peril has been covered by the federal government through the NFIP. Some rates have been highly subsidized, and individual state involvement has been negligible. The federal subsidy with little to no state involvement is different from how other perils are covered, which leads to rating questions:

- What kind of support is required for flood endorsement rate filings? For excess NFIP flood filings? Stand-alone flood policies?
    - Regulatory—will filings be prior approval, file and use, or use and file? Commercial versus residential differences? Will federal regulation be

involved? Will the domiciliary state have the same freedom as it does for other perils in rate and coverage approval processes?
    - The NFIP views flood hazards based on national experience. Will multistate experience be considered, or will rates be determined based on experience in each individual state or territory?
    - Are there any other limitations/requirements with respect to rate determination?
- How will private markets develop their rates?
    - Use of commercial flood catastrophe models or internal company models for underwriting and/or rates?
    - Reinsurance expenses?
    - Profit and contingency loads?
    - Multistate data or local experience?
- What will the individual state requirements be for using catastrophe models in rating?
    - The Florida Commission on Hurricane Loss Projection Methodology[1] has standards for flood models. Will other states adopt their own requirements?
- Will inland flood be rated and regulated along with coastal surge?
    - The Florida Commission considers these in tandem. How will other jurisdictions treat them?
- In what manner will the federal government (NFIP) and individual states interact?
    - Will the NFIP price/product be considered when approving new private-sector flood products?
    - If a private policy is written that had been insured by FEMA, will the risk still be NFIP-eligible if the policyholder chooses to leave the private market?
    - Will private insurers be required to collect NFIP reserve surcharge and flood mapping fees now collected on federal flood insurance policies?
    - Does privatization contemplate continued use of federal flood maps, or will insurers be expected to come up with their own flood risk assessments? Will the states take a bigger role in flood mapping in the future?

E Building Standards

Under current law, for homeowners and businesses to be eligible for NFIP coverage, their communities must enact land use plans and building codes that require certain levels of property protection. Will state governments assume a larger role in encouraging improvements in local

[1] The Florida Commission on Hurricane Loss Projection Methodology is a state-established body whose approval is required for the submission of residential property hurricane rates that use catastrophe models in their development in Florida. The Commission has adopted a similar process for flood models, which will be used by the Florida Office of Insurance Regulators once effective.

building standards? Similarly, community planning relies upon federal flood maps that are funded in part by surcharges on NFIP policies. If funding for FEMA's flood mapping program declines, will the states step in with their own funds or with alternative mapping programs?

F Financial Issues

With the addition of private flood protection included in the products provided by insurance carriers, there could be an effect on the financial reporting of these private insurance companies. In turn, state regulators may see an increase in reporting to the state agency requiring additional oversight and work. Changes to annual statements will need to be made through considerations such as:

- How should flood be reflected on financial statements?
- Will a separate line of business for non-federal coverage be needed in the Annual Statements of insurance companies?
- Will flood premium be subject to state premium tax?
- Does the catastrophic nature of flood require any special reports or data calls? If so, what should the core or minimum requirements for this additional reporting be?
- How will endorsements to homeowners insurance policies be captured for reporting purposes?
- How will flood insurance be reflected in risk-based capital assumptions and calculations?

G State Guarantee and Residual Funds

The catastrophic nature of flooding puts entire communities at risk. Privatization of flood insurance could open markets to enable expanded insurance protection from private insurance carriers. Yet not all community members will be able to obtain flood coverage from private carriers. Therefore, a community with extreme risks may have persons in need of protection. Two extreme risk-pooling mechanisms have arisen: state guarantee funds and residual funds. Here are several issues to consider about the extreme risk pooling mechanism and flood privatization:

- Are private flood policies covered by the state guaranty funds?
- Will flood coverage be subject to assessments for guaranty funds?
- Will flood coverage be written in a state's property residual market?
- Will State Fund and Residual Fund policies provide the same limits as the NFIP—e.g., up to $250,000 for dwellings and up to $100,000 for contents?
- Will there be state-specific residual flood markets?

    - Neither Florida Citizens Property Insurance Corporation[2] nor the Florida Cat Fund[3] currently cover flood losses. How will other states handle flood loss coverage?
    - How will these unique coverages be coordinated with the private marketplace?
    - How will they be priced?
- Will flood premium be considered along with assessment bases for residual markets, windpools, or Fair Access to Insurance Requirements (FAIR) Plans?[4]
- Will flood policies written in coastal areas be eligible for voluntary writing credit from the windpool? If yes, under what circumstances? (Note: A voluntary writing credit could involve whether flood is written stand-alone or as an endorsement to home owners policies.)

II Reinsurance

The catastrophic nature of the flood hazard presents private insurers with the potential for greater volatility of earnings, increased risk of capital-damaging occurrences, and even solvency risk. To mitigate these risks, private-sector companies use various risk-sharing mechanisms, including reinsurance, which could lead to questions around the use of reinsurance in the private flood market:

- Will a large portion of the private market risk be transferred via reinsurance?
- Will the private market simply pass through the variable cost of reinsurance without regulatory issues?
- Given that the highest-flood-risk areas often are the same as the high-hurricane-risk areas, will the additional drain on capacity in these markets cause increased cost of reinsurance?
- Will the primary insurer be required to retain any of the flood insurance risk, or can they pass all or most of it through to reinsurance companies?
- If a high portion of the flood insurance risk is passed through to reinsurers, how does the increase in risk impact availability and price volatility as reinsurance market conditions vary from year to year?

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[2] Florida Citizens Property Insurance Corporation is the residual market in the state of Florida.
[3] The Florida Hurricane Catastrophe Fund is a state entity with the mission of increasing insurance capacity within the state, serving as an alternative to reinsurance.
[4] Residual markets, windpools and FAIR Plans are various forms of state-mandated access to property insurance when the buyer is not able to obtain coverage in the marketplace.

III Appendix—Highlights of Flood Protection History

The Insurance Information Institute has provided information about flood protection. Its recent report gives some context to the flood privatization issue. The beginning of its "Facts About Flood Insurance" report gives the following background:

> "According to the Federal Emergency Management Agency (FEMA) floods—including inland flooding, flash floods and flooding from seasonal storms—occur in every region of the United States. In fact, 90 percent of all natural disasters in the U.S. involve some type of flooding."[5]
>
> "Flood damage is excluded under standard homeowners and renters insurance policies. However, flood coverage is available in the form of a separate policy both from the National Flood Insurance Program (NFIP) and from a few private insurers.
>
> Congress created the NFIP in 1968 in response to the rising cost of taxpayer-funded disaster relief for flood victims and the increasing amount of damage caused by floods. … The NFIP provides coverage for up to $250,000 for the structure of the home and up to $100,000 for personal possessions. … In 2016 the NFIP began a reinsurance program to put it in a better position to manage losses incurred from major events by transferring exposure to reinsurers."[6]

The Insurance Information Institute website also compiled and shared statistics on the growth in both the size of the NFIP program, in terms of Policies in Force (PIF), the protection provided, and claim payments made to NFIP policyholders:

National Flood Insurance Program, 1980-2016[7]

Year	Policies in force at year-end	Avg Annual % Growth in PIF	Losses paid: Number	Losses paid: Amount ($000s)
1980	2,103,851		41,918	$230,414
1985	2,016,785	-0.8%	38,676	368,239
1990	2,477,861	4.2%	14,766	167,897
1995	3,476,829	7.0%	62,441	1,295,578
2000	4,369,087	4.7%	16,362	251,721
2005	4,962,011	2.6%	213,593	17,770,443
2007	5,655,919	6.8%	23,191	614,091
2008	5,684,275	0.5%	74,980	3,489,569
2009	5,700,235	0.3%	31,034	779,974
2010	5,645,436	-1.0%	29,164	773,706

As of October 2017, there were 131,616 NFIP claims from superstorm Sandy. The average paid loss was $65,547, compared with 168,019 claims from Katrina, with an average paid loss of $97,147.

In 2016 the average amount of flood coverage was $246,890, and the average premium was $656.

[5] Insurance Information Institute; "Facts About Flood Insurance"; accessed Feb. 22, 2018.
[6] Insurance Information Institute; "Facts + Statistics: Flood Insurance"; accessed Feb. 26, 2018.
[7] Ibid.; (Average Annual Growth in Policies In Force [PIF] added).

2011	5,646,144	0.0%	78,236	2,429,440
2012	5,620,017	-0.5%	151,849	9,516,995
2013	5,568,642	-0.9%	18,118	492,542
2014	5,406,725	-2.9%	12,907	380,222
2015	5,205,094	-3.7%	25,798	1,028,338
2016	5,081,470	-2.4%	59,332	3,693,244

The average flood claim in 2016 was $62,247, about the same as $62,674 in 2012, the year of Sandy.

NFIP earned premiums fell 3.0 percent to $3.33 billion in 2016 from $3.44 billion in 2015.

Because the National Flood Insurance Program is administered by FEMA, another helpful source for historical background is the FEMA website. Since the NFIP was launched by Congress in 1968, many regulations have retooled the NFIP. Here is a comprehensive list from FEMA with embedded links (years added to turn the alphabetical source page list into this chronology):

National Flood Insurance Program: Laws & Regulations[8]

Last Year Updated	Law or Regulation
2017	Write Your Own (WYO) Company Arrangements
2014	Homeowner Flood Insurance Affordability Act of 2014
2012	Biggert-Waters Flood Insurance Act of 2012 (text begins on page 512)
2012	Standard Flood Insurance Policy Forms
2010	NFIP Statutory Authority
2004	Flood Insurance Reform Act of 2004
1994	National Flood Insurance Reform Act of 1994
1994	NFIRA of 1994 Bulletins
1990	Coastal Barrier Improvement Act of 1990 (CBIA)
1982	Coastal Barrier Resources Act (CBRA)
1968 - 1975	Title 44 Code of Federal Regulations (CFR), sections 59 through 80
1973	National Flood Insurance Act of 1968 & Flood Disaster Protection Act of 1973
1968	U.S. Code, title 42 - National Flood Insurance Program

[8] Federal Emergency Management Agency; "National Flood Insurance Program: Laws & Regulations"; accessed Feb. 26, 2018.