

**OPPORTUNITIES FOR A PRIVATE AND  
COMPETITIVE SUSTAINABLE FLOOD  
INSURANCE MARKET**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
HOUSING AND INSURANCE  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED THIRTEENTH CONGRESS  
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## **OPPORTUNITIES FOR A PRIVATE AND COMPETITIVE SUSTAINABLE FLOOD INSURANCE MARKET**

**Wednesday, November 19, 2014**

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON HOUSING AND INSURANCE,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:01 p.m., in room 2123, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Luetkemeyer, Garrett, Westmoreland, Hurt, Ross; and Capuano.

Also present: Representative Murphy.

Chairman NEUGEBAUER. Good afternoon. This hearing of the Subcommittee on Housing and Insurance will come to order. The title of today's hearing is, "Opportunities for a Private and Competitive Sustainable Flood Insurance Market." We will have opening statements limited to 10 minutes on each side. I also ask unanimous consent that members of the full Financial Services Committee who are not members of the subcommittee, and who have joined us today, will be entitled to participate. Without objection, it is so ordered.

One of the things that is going to happen is probably right after we do the opening statements—and I don't know if we will get through the testimony of the panel before the next round of votes is called—but the plan is, is when they call votes we will briefly adjourn. We will go over, vote, and get back as quickly as we can and continue with this very important hearing.

As I mentioned, the title of today's hearing is, "Opportunities for a Private and Competitive Sustainable Flood Insurance Market." One of the things that this Congress has done in the past is, it initiated a flood insurance program. Because what they found was, there was not a ready market for that at that particular time.

Along the way, the Congress also decided that we needed to provide for private companies to participate in the market. And then, this Congress also decided that in the future, the taxpayers shouldn't have to subsidize people who live in areas that are higher-prone to flooding. And we said that they should start to pay actuarial rates.

I think one of the reasons that this hearing is so important is that if we are going to move towards a private participation in the marketplace, we have to get the government out of the way, and

we need to facilitate the ability for the private sector to be a part of this.

I am very pleased that today we are going to be examining H.R. 4558, which is the Flood Insurance Market Parity and Modernization Act of 2014. And I would like to thank the cosponsors, Mr. Ross and Mr. Murphy, for their work on this.

Why is this important? One of the things that choice brings is competitive pricing. And if you have the government dominating an area, it doesn't really allow for a lot of private participation. So, one of the things we want to see is for consumers to have choices.

The other reason this is important is that it would be good to transition out of the taxpayers backing up the flood insurance market and letting private capital back that up. Why that is important to the taxpayers is, we have seen that when the government is involved in the insurance business it prices risk politically rather than actuarially. We think it is a novel idea to let the marketplace price the rules risk, and we want to provide a pathway to do that. As you probably know, currently the flood insurance program is in the hole and the taxpayers have had to ante up about \$24 billion to subsidize people who, unfortunately, were not paying an actuarial rate for their insurance.

What we will learn today about H.R. 4558 is that it has some common-sense approaches to providing for private participation in the flood insurance market. One of the things we don't need to do is send a signal to lenders, for example, that there is only really one source for flood insurance. There are multiple sources for flood insurance. And one of the things we have heard from the industry, the people in the insurance business, is we have seen in some areas where the people in the insurance business don't want to go and participate in those markets. But particularly, the flood insurance market is, quite honestly, a part of the market where we have seen an interest in that participation.

So I thank the witnesses for being here. And, again, I want to thank Mr. Ross and Mr. Murphy for their thoughtful bill. With that, I will turn to my ranking member, and my good friend, Mr. Capuano, for his opening statement.

Mr. CAPUANO. Thank you, Mr. Chairman. I will be brief. I came to learn because, like with many things, I don't know much about this. But I know a couple of things. And the one thing I know is that we have flood insurance because we haven't found a better way to do it. That is why we have government-backed flood insurance. We have a better way to do it if we want to have—make sure that no one can afford it. That kind of defeats the purpose of flood insurance.

So I am open to any education on how we can have private enterprise do this and keep it affordable. Now, it is kind of funny. Over the last year or so, it turns out that apparently as a liberal Democrat, I have now become the poster child, or one of the many poster children for corporate welfare because I support TRIA and I supported the flood insurance bill and other such things.

But that is one way to put it. To me, the other way to put it is, how do I get necessary insurance coverage to people who need it, that is affordable? And if it is not affordable, it doesn't matter how good the coverage is; nobody will buy it. So, for me, that is what

I am open to learn. I would love to hear how the numbers work and why it would not be corporate welfare for us to change the system we have.

And I look forward to the testimony, thank you.

Chairman NEUGEBAUER. I haven't seen that poster. I would like to.

Mr. CAPUANO. I thought you had one.

Chairman NEUGEBAUER. No. Now, I turn to the vice chairman of our Housing and Insurance Subcommittee, Mr. Luetkemeyer from Missouri, for 1 minute.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

My district includes many communities that sit in the floodplains along major rivers, streams, and lakes. In fact, one lake in my district has more miles of shoreline than the State of California. So you can see how big a problem this is to me. I hear from my constituents about the National Flood Insurance Program (NFIP) nearly every day, and it is clear that the NFIP is broken.

I owe it to the families and business owners living in those communities, and we owe it to all Americans, to create a flood insurance program that is stable, fair, accessible, and cost-effective. It cannot continue to be a program that exposes taxpayers to endless risk, and it doesn't have to be.

To create a more stable and cost-effective program, we need to allow the private market to enter the space instead of inhibiting its ability to do so. The bill introduced by my colleagues from Florida does just that.

Today, we will hear from experts whom I expect will tell us that there is room for the private market in the flood insurance space. And we need to encourage this market so we can deliver a better product to our constituents. I look forward to hearing from our panelists.

And I yield back, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the chairman of our Capital Markets Subcommittee, Mr. Garrett from New Jersey, is recognized for 2 minutes.

Mr. GARRETT. Thank you. And I thank the chairman for holding this hearing on how we can improve the market for flood insurance across this country. And I would also like to thank all of the witnesses who are here, as well.

Speaking as someone who is literally on the ground, who has viewed the devastation and helped do some of the hands-on clean-up of our last storm in the State of New Jersey, I know the importance of a well-functioning flood insurance market. Unfortunately, we have a government-backed flood insurance program that simply is not working. In fact, we know that in the wake of Hurricane Sandy, Congress had to bail out the National Flood Insurance Program to the tune of nearly \$10 billion to make good on the promises the Federal Government made to the flood-ravaged homeowners here.

The facts seem to suggest that Uncle Sam makes for a terrible risk manager, let alone an insurance executive with a monopoly on the marketplace. Congress must do what we can to encourage Uncle Sam to step aside and let the private market assume some of the risk rather than let the risk fall on the U.S. taxpayer?

I am interested to hear what changes Congress can make to the current law to remove obstacles that discourage private participation in the flood insurance marketplace.

My initial sense is that an abundance of red tape, future regulatory uncertainty, and the shadow of the current National Flood Insurance Program all combine to continue to make private capital stay on the sidelines. So at the end of the day, we need to make some changes.

The NFIP isn't fair to homeowners who rely on a bankrupt system in time of catastrophe. Nor is the current system fair to taxpayers, who ensure the program remains on a dry financial footing. And with that, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Virginia, Mr. Hurt, is recognized for 2 minutes.

Mr. HURT. Thank you, Mr. Chairman. Thank you for holding today's hearing to consider legislative reforms to the National Flood Insurance Program.

Our current government-provided flood insurance system has proven ineffective, inefficient, and costly to taxpayers. While Congress has previously been successful in implementing modest reforms to the NFIP, we still face a situation where Congress has chosen to solidify the NFIP's broken balance sheet with little hope for returning it from the red.

With \$24 billion in debt, and the potential for moral hazard created by the program as it is currently structured, it is critical that this subcommittee work to pursue significant reforms. These reforms will allow us to chart a new course for the NFIP, and put the program on a more sound financial footing. Hardworking taxpayers deserve a Federal flood insurance program that is fiscally responsible.

We must enhance the program's integrity, make it self-sustaining, increase private market coverage, and reduce the risk to taxpayers across this country. We can no longer settle for the status quo of a flood insurance program that crowds out the private sector in order to subsidize insurance premiums for a few Americans at the expense of the rest of the country.

Going forward, this subcommittee must be a leader in the effort to reform the NFIP to a private, competitive, and sustainable flood insurance market. I would like to thank our distinguished witnesses for appearing before the subcommittee today, and I look forward to your testimony on the concepts for NFIP reform.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Florida, Mr. Ross, one of the lead sponsors of this piece of legislation, is recognized for 2 minutes.

Mr. ROSS. Thank you, Mr. Chairman, and thank you for holding this important hearing about an issue to which I am deeply committed. And that is providing Florida and American homeowners more affordable consumer options in the flood insurance marketplace.

I would also like to thank our distinguished panelists today for their testimony. And I would especially like to thank Representa-

tive Patrick Murphy for joining me in introducing this Flood Insurance Market Parity and Modernization Act of 2014, which we will be discussing this afternoon.

Mr. Chairman, the implementation of the Biggert-Waters Flood Insurance Reform Act of 2012, or BW-12, has proven to be problematic. Before Congress acted earlier this year to provide relief for homeowners with National Flood Insurance Program policies, I was hearing reports from my constituents of \$15,000-a-year increases in premiums.

The intent of BW-12 was to give consumers additional insurance policy options beyond the National Flood Insurance Program. However, today homeowners are trapped in a system that forces them to purchase the taxpayer-backed Federal insurance product from a program that was already \$24 billion in debt at the end of 2013.

So why is the Flood Insurance Market Parity and Modernization Act of 2014 necessary? Section 239 of BW-12 made clear that the intent of Congress was to allow homeowners the option to pursue private flood insurance. Unfortunately, BW-12 narrowly defined acceptable flood insurance programs, thereby limiting the flexibility of State regulators to license private flood insurance products. These restrictions prevent innovation and consumer choice.

With Florida homeowners in mind, Representative Murphy and I introduced legislation that redefines private flood insurance to remove Federal restrictions and requirements on coverage. In doing so, we would return the full authority of determining acceptable coverage of insurance policies to State regulators.

Florida's insurance commissioner, Kevin McCarty, has offered his support of this common-sense legislation. At this point, I would ask unanimous consent to submit his letter dated July 11, 2014, for the record.

Chairman NEUGEBAUER. Without objection, it is so ordered.

Mr. ROSS. Mr. Chairman, allowing more consumer choice in the government-dominated flood insurance market creates competition and results in better policies and pricing that will benefit homeowners.

With that in mind, I look forward to this hearing, and I yield back my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the other lead sponsor of this important piece of legislation, the other gentleman from Florida, Mr. Murphy, is recognized for 2 minutes.

Mr. MURPHY. Thank you, Mr. Chairman. I want to thank Chairman Neugebauer and Ranking Member Capuano for today's hearing on how we can make flood insurance more affordable for middle-class families. I would also like to thank the witnesses for their testimony and their time, and my good friend and fellow Floridian, Mr. Dennis Ross, for his in-depth understanding of insurance issues and his commitment to giving Floridians a choice.

The National Flood Insurance Program has served as a critical lifeline for many families in my district, enabling them to have peace of mind and protect their homes which, for most middle-class families, is their most valuable asset.

Stepping in and creating a market where there is none for affordable options for middle-class families I believe is an appropriate

use of government. I believe that together we can and should protect our homes and our housing market.

However, what happens when government is the only game in town and stands in the way of what promises to be a viable private market? We saw these results on full display: families waiting on FEMA to decide what is affordable; entire neighborhoods waiting on Congress to act to shield them from impossible rate hikes; no customer service hotline and no ability to switch carriers. I don't believe that any of us, especially those of us who defend the NFIP and support the goals of this program, want to do this to our constituents.

Excessively prescriptive, top-down statutory Federal requirements are crowding innovation and consumer choice out of the market. Biggert-Waters correctly intended to foster the creation of a private market. Sadly, in this area, the law has fallen short.

I could not be happier to work with Mr. Ross and my colleagues on both sides of the aisle to explore and improve the bill before us to protect consumers, foster innovation and choice, and ultimately do what is right for middle-class families.

I yield the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman.

We will go to our panelists. And I would just remind our panelists that your oral testimony will be limited to 5 minutes, but your complete written testimony will be made a part of the record.

Our panel today consists of: Mr. Stephen Ellis, vice president of Taxpayers for Common Sense; Mr. Jordan Gray, senior vice president and general counsel of WNC Insurance Services; and I will turn to Mr. Ross to introduce our third panelist.

Mr. ROSS. Thank you, Mr. Chairman. It is a distinct honor for me to introduce our third panelist, with whom I had the honor of serving as a legislator in the Florida House of Representatives. A former independent insurance agent and past chairman of several House insurance committees in the Florida legislature, Mr. Don Brown.

Chairman NEUGEBAUER. I thank the gentleman.

And Mr. Ellis, you are now recognized for 5 minutes.

**STATEMENT OF STEVE ELLIS, VICE PRESIDENT, TAXPAYERS FOR COMMON SENSE**

Mr. ELLIS. Thank you, Mr. Chairman. Good afternoon, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. I am Steve Ellis, vice president of Taxpayers for Common Sense (TCS), a national nonpartisan budget watchdog. Thank you for inviting me here today to testify on H.R. 4558, the Flood Insurance Market Parity and Modernization Act of 2014, and issues involving the private flood insurance market.

A little bit of background. Since the late 1980s, the National Flood Insurance Program teetered on either side of solvency, covering shortfalls with Treasury borrowing and repaying the loans in years of surplus. Then in 2005, the inevitable happened, a catastrophic loss year, and the program was roughly \$18 billion in debt to the Treasury. That was followed by the Super Storm Sandy losses in 2012, and now the program is more than \$24 billion in debt to taxpayers. To put that into perspective, FEMA data indi-

cates that in 2013, the 5.6 million policies in the program resulted in \$3.5 billion in premium to insure \$1.3 trillion worth of property.

The U.S. Government Accountability Office has estimated that approximately 20 percent of policies are explicitly subsidized and paying only 35 to 40 percent—45 percent of their actual full-risk premiums. As this subcommittee well knows, reforms to the NFIP were enacted in 2012 to increase premiums to more risk-based rates which would not only help program solvency, but also help policyholders better understand their risks and to take measures to mitigate that risk. Despite some concerns, TCS supported the 2012 legislation, while also favoring additional efforts to help address affordability issues.

Unfortunately, earlier this year Congress reacted to a vocal minority and largely rolled back the 2012 reforms that could have led to more actuarial rates. To obtain a mortgage, property owners in special—in designated special flood hazard areas, typically those with a 1 percent chance of flooding in any given year, are required to purchase flood insurance. As long as it met NFIP coverage standards, private flood insurance could be an alternative to Federal flood insurance to meet the mandatory purchase requirement. As the shift to more risk-based rates under reform neared, the private markets started to strengthen. States like West Virginia and Florida enacted legislation to regulate new private flood insurance alternatives in their States.

However, the 2012 flood insurance bill went further than before and attempted to quasi-regulate what exactly constituted private flood insurance by including a proviso that private flood insurance be “at least as broad” and essentially mirror NFIP policy. This resulted in lenders rejecting some private policies as not meeting legal requirements. For example, a homeowner may want to purchase a higher coverage limit with a higher deductible than is available under NFIP. Current law would result in that policy being rejected by the lender as not meeting the legislative private flood insurance definition.

The whole point of allowing private flood insurance alternative is to create competition and choice in the marketplace and reduce the possible burden on the taxpayer. Furthermore, insurance is regulated at the State level. The Federal Government leaves decisions on homeowners insurance and car insurance to the States. They should do the same for private flood insurance alternatives.

This is why Taxpayers for Common Sense supports the aforementioned H.R. 4558. This legislation would remove the restrictive and confusing language, and define private flood insurance as an insurance policy that is issued by an insurance company that is licensed or approved in the State where the property is located.

This does not remove the mandatory purchase requirement in minimum coverage level. This just allows insurance commissioners to regulate the product in their State the way it is done for other insurance lines.

One recommendation that TCS has would be to clarify that if a homeowner opts for uninterrupted coverage through a private policy, the homeowner should not be treated as having a lapse in coverage under NFIP. This would allow the homeowner to return to NFIP if they desire, without penalty. The only reason a policy-

holder will opt for private insurance over NFIP is because the private insurance offers a better product, a better price, or both.

To stifle the private market would be akin to the Federal Government forcing policyholders to pay more for their insurance. In addition to the definitional issue, the existence of subsidized Federal flood insurance is a barrier to the development of a robust private market. Simply put, NFIP occupies the space where the private sector would operate. It is true that the NFIP was created because there wasn't a functioning private insurance marketplace. But that was nearly 50 years ago. It almost goes without saying that technology and modeling have advanced dramatically.

Imagery and mapping technology have similarly developed. The reinsurance and financial instruments to manage risk are much larger and more diversified. Many countries in the world have private flood insurance either bundled into property insurance or as a separate, or add-on, coverage. These are typically backed by reinsurance. In fact, the United States is one of the only countries with a State-backed separate policy of flood insurance.

The development of a private flood insurance market in the United States would serve to shift some of the post-disaster recovery and rebuilding burden from taxpayers to the private sector and those who choose to live in high-risk areas.

It could also be a powerful tool to encourage mitigation in the face of increased disasters and sea level rise. The National Flood Insurance Program is \$24 billion in debt to the taxpayer. While the decision to repeal many of the 2012 reforms was a setback, Congress could enact H.R. 4558 to at least let private flood insurance have a chance.

Thank you very much.

[The prepared statement of Mr. Ellis can be found on page 28 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Gray, you are now recognized for 5 minutes.

**STATEMENT OF JORDAN N. GRAY, SENIOR VICE PRESIDENT  
AND GENERAL COUNSEL, WNC INSURANCE SERVICES, INC.**

Mr. GRAY. Chairman Neugebauer and members of the subcommittee, thank you for the opportunity to testify today. My name is Jordan Gray. I am senior vice president and general counsel of WNC Insurance Services. My testimony today is on behalf of my company, WNC, and my full testimony has been submitted to the subcommittee in writing.

Founded in 1962, WNC is an independent managing general agency and surplus lines broker representing several A-rated private flood insurance carriers. Today, WNC serves nearly 3,000 small and mid-market community banks and credit unions, hundreds of independent agents and brokers, and thousands of homeowners and businesses, providing insurance products and services, including private flood insurance.

WNC is grateful for the National Flood Insurance Program. The NFIP is the entrepreneurial catalyst that created an important industry. The industry is now ready for the next phase of its growth and evolution: privatization.

WNC is also grateful for the Biggert-Waters Flood Insurance Reform Act of 2012. Biggert-Waters is evidence that both sides of the aisle can work together to—

[Audio drop.]

Was my testimony that bad?

[laughter]

Chairman NEUGEBAUER. It does that to me, too.

Mr. GRAY. —both sides of the aisle. We are pleased with this idea. We support H.R. 4558. It is a simple bill that provides an appropriate fix to an unintended consequence of Biggert-Waters. One unintended consequence of Biggert-Waters is that it makes it more difficult for lenders to accept private flood insurance in satisfaction of the mandatory purchase of flood insurance requirement, thereby impeding the long-established public policy goal of private market involvement in flood insurance cited in Biggert-Waters.

What was intended to liberate both borrower and lender alike has now placed them in a straitjacket of regulatory compliance, mandating that bankers become insurance professionals and insurance professionals become bankers, leaving these industries in confusion.

So what does this confusion look like? Here is an example. When a loan is about to close, there is a mandatory purchase obligation if the property is located in a special flood hazard area. But the problem is that the Federal flood policy only provides \$500,000 of coverage for the \$5 million building at risk.

So the borrower purchases a private policy. The carrier and the broker are certain that this private policy is exactly what the borrower needs. The borrower takes the policy to the lender to close the loan, but the compliance department tells the borrower that it cannot accept the private policy if it doesn't follow the National Flood Insurance Program general property insurance form exactly as written. The lender is frustrated because it knows that it must comply with the regulations or face potential fines and penalties, but it doesn't really have the expertise to tell what is truly a good policy.

The borrower is frustrated because they cannot purchase the product they want, and cannot close the loan on time. The carrier and the agent are frustrated because they have a perfectly good product that fails to meet a perceived or actual technical definition of private flood insurance. But yet the policy will perform as good, or better than, the Federal policy when a loss occurs.

The solution is simple. Give lenders and borrowers the same discretion to evaluate flood insurance as they have to evaluate all insurance products. H.R. 4558 does this.

In conclusion, there is a private market waiting to provide flood insurance. There is a hopeful lending market looking for some regulatory relief. There are eager policyholders looking forward to quality coverage becoming widely available in the private market. H.R. 4558 is the next step.

And I thank you for the opportunity to testify today.

[The prepared statement of Mr. Gray can be found on page 31 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman, and apologize for the slight interruption there.

Mr. Brown, you are now recognized for 5 minutes.

**STATEMENT OF DON BROWN, FLORIDA PROPERTY  
INSURANCE EXPERT**

Mr. BROWN. Thank you, Mr. Chairman. It was my intention as I open my remarks to refer to you by your name. But, Mr. Chairman, because of my Southern accent I was really afraid to maybe—that I might mess it up.

Chairman NEUGEBAUER. Mr. Brown, it is very easy. It is “RAND-D.”

Mr. BROWN. Mr. Chairman, Ranking Member Capuano, and members of the subcommittee, thank you for having me here today. My name is Don Brown and I currently work as a lobbyist representing insurance and reinsurance companies in the State of Florida. Previously, I served in the Florida House for 8 years, and was an insurance agency owner for 28 years.

When the NFIP was established, of course, flood was generally considered an uninsured peril and few private companies were willing to write the risk. There was no history of loss, no models for flood, and generally the insured knew much more about their potential for loss than the insurance company.

A flood is no longer an uninsurable risk, and the private market is no longer unwilling to write flood. There are several reasons for this development. In the last few years, commercial flood models have been developed that have given insurance companies a wealth of information regarding flood risk. Consequently, there has been an influx of capital into the reinsurance and insurance arena. And that capital is interested in underwriting flood risk. These developments provide new options for consumers when buying flood insurance.

One additional consumer benefit to the development of a private flood market is that it is regulated by State insurance departments, which have a long history of consumer protection as their very foundation.

I believe there will always be a need for a program like the NFIP, but there is plenty of flood risk out there that can be written by private companies. And I can tell you that many of my clients are eager to write flood policies. There are three obstacles that I believe the bill before you today addresses, but it is important that we recognize these.

The first obstacle is that the law currently permits several different Federal agencies, as many as five, to regulate flood companies. These agencies could issue different requirements even years in the future that would throw the private market into disarray. This creates uncertainty and has a stifling effect on the private market. H.R. 4558 addresses this problem by removing some of that uncertainty. Please allow me to expand briefly on the notion that uncertainty can be an impediment to the formation of a healthy private insurance market.

In his landmark book, “Risk, Uncertainty and Profit,” Dr. Frank H. Knight defined the difference between risk and uncertainty like this: Risk is present when future events occur with measurable probability. Uncertainty, on the other hand, is present when the likelihood of future events are indefinite or incalculable. Dr. Knight

goes on to explain in his book that in addition to uncertainty about our natural environment, in this case the weather, political and regulatory uncertainty can also impede private capital formation. Today the greatest impediment, in my opinion, to capital formation in the private flood market is political and regulatory uncertainty.

The second obstacle that the law defines: coverage to include deductibles. Deductibles are not usually considered part of coverage when discussing a policy of insurance. As someone who sold insurance policies for decades, I can tell you that when I discuss coverage with a customer, I am usually talking about the exclusions and the conditions precedent, not the point at which the coverage actually attaches.

The problem is this: It is unclear if private companies can offer additional options regarding deductibles and still have the policy considered to be comparable coverage to the NFIP. The term “deductible” should be removed from the law so that consumers have a wide variety of options.

The third obstacle is what I will call “grandfathering”—it has been referred to earlier in the testimony—of subsidized rates for NFIP consumers who go to a private carrier. Under current law, it is not clear how the NFIP would rate a policy when a property moves from the NFIP to the private carrier and then wishes to come back to the NFIP. Clarifying that a customer can return to the NFIP on the same glide path that they are currently on would make me, as an agent, feel more comfortable selling a private flood policy.

Notwithstanding the unprecedented capital inflow to the global catastrophe market over the last several years, one other obstacle to the expansion of a private flood program would be to impose a new tax on the reinsurance market. In my written testimony, you can read further about my comments on that regard.

In conclusion, I want to thank the committee for all your work, all the work you have done on flood insurance to date. Amazing progress has been made, and I do believe there is an opportunity for a vibrant private flood market. Thank you for your time and for inviting me to testify before you, and I would be happy to answer any questions.

Thank you.

[The prepared statement of Mr. Brown can be found on page 24 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman. And we now have three votes so we are going to recess until right after votes. The Chair intends to start the hearing back up ASAP, as soon as we get back. So I ask Members to continue to vote and hurry on back. And with that, we are in recess.

[recess]

Chairman NEUGEBAUER. The subcommittee will come to order. Thank you for your patience. What should have been a 30-minute exercise turned into nearly an hour exercise. I guess we are trying to stretch out this little bit of work that we were doing as to make it look like we are working a lot harder, or something. Each Member now will go into questions for the panel. Each Member will have 5 minutes. I will begin that questioning now.

The NFIP program was created in 1968. And at that particular time, as I think one of the witnesses mentioned, there wasn't credible data and it was hard to predict, and it made it difficult to underwrite those risks. But things have changed today, and we have the data, the mapping has been done. Are there any other barriers that you see outstanding there that would keep us from moving back to a private system? Is there a missing piece here? I will start with Mr. Ellis.

Mr. ELLIS. Yes, Mr. Chairman. I think one of the missing pieces is being addressed by this bill. And that is, actually, this clarification as to what is private flood insurance and how can it be implemented or how will it meet the mandatory purchase requirement. And I think that is one of the things that this really clarifies. Because even before Biggert-Waters—Biggert-Waters really codified some of the informal criteria that FEMA had that also was sort of limiting the acceptance of private insurance coverage as an alternative for the mandatory purchase requirement.

So I think this is one of the big hurdles. And then, obviously, the other big hurdle will be the private sector has to make a profit. And, if you have a subsidized Federal program, particularly in the case of the pre-firm properties, it is going to always keep those people, those properties, in the program and inhibit the development of a private marketplace.

Chairman NEUGEBAUER. Mr. Gray, Mr. Brown, anyone want to elaborate on that?

Mr. BROWN. I would just simply concur that the uncertainty that I spoke about is really the greatest impediment to the private market coming in. I can assure you that interest has been expressed. In fact, just before I came today I got an e-mail from one of my clients. Let me just share it with you. I won't attribute it, but they said the real private market really, really, really wants to cover risk in the United States. It is getting boring only paying flood claims in most of the rest of the world.

The private market pays flood claims everywhere else, but not here. The impediment is that when there is enough certainty—I think of uncertainty in the context of Dr. Knight's statement. If you think of it as a spectrum and, on the one hand, you have risk and on the one hand you have uncertainty, the extent to which you move across that spectrum from uncertainty to risk is the extent to which capital will come in and take the place of a government program. So the more certainty that Congress can provide about what coverage is going to be required, and provide some flexibility, is the extent to which the private sector will step in and take up this risk.

Chairman NEUGEBAUER. One of the things that—unfortunately, we are in a situation right now where the Federal Government controls about 90 percent of the mortgage market. And obviously, in the mortgage finance area, in many cases, there are requirements that properties in certain flood areas are required to carry flood insurance. If you have an FHA loan, I guess you have to have the loan guaranteed by Freddie Mac and Fannie Mae—those have to. Have you detected any bias out there, where those agencies are, say, looking more favorably upon an NFIP policy versus a private policy?

Does that prejudice, do you think, exist in the marketplace? Do we need to address that? Does anybody have any data or thoughts on that?

Mr. ELLIS. Mr. Chairman, it is true that even though there is this mandatory purchase requirement it is not incredibly well-enforced by the lenders. I think it is less than half of—estimated less than half of the properties that are required to have it actually do. And so, in some cases, it is that the person gets the insurance to get the loan and then drops coverage a few years later. The lender is not necessarily enforcing it, particularly if it has gone into the secondary market. So, the GSE is one of the things—if they were pushing the lenders more to require just flood insurance—whether it is Federal or private—that would actually help drive that marketplace, as well.

Chairman NEUGEBAUER. So what you are saying is, enforcing the servicers to make sure that they are complying with that?

Mr. ELLIS. Yes, Mr. Chairman. And they are actually—in the 2012 bill, there were actually increased penalties for lenders that were not doing that. And it is just this question of whether there is actually this enforcement and oversight.

Chairman NEUGEBAUER. And how do we—Mr. Brown, you have been in the insurance business and had an agency for a number of years. And what happens in a lot of business, is it just gets more comfortable. Would you say across the country that the agents are more comfortable selling an NFIP policy versus a private policy, because the NFIP has been a long-established program? And if so, how do we break that mold?

Mr. BROWN. I think one of the most important ways to break that mold is what we are doing right here today. And that is, bringing clarity to the fact that coverages can be offered by admitted carriers in States where the State regulator has certified that the coverage being offered is something that would serve their constituency. And yes, there is, I believe, some built-in bias in favor of the program because it is a known quantity. And the extent to which we can make the private offer of flood coverage a known quantity is the extent to which we are going to have success moving this risk from the government to the private sector.

Chairman NEUGEBAUER. When you look at where the insurance industry is spending its money they talk about we want to insure your house, your car, your life, your health insurance, your business, et cetera. Do you think if the industry felt like there was a better opportunity for expansion in that area that they would be more focused on promoting the fact that they offer private flood insurance?

Mr. BROWN. I don't think there is any question of that. And that goes hand-in-hand with the willingness of the reinsurance market to step in and take some of that risk. Yes, there are some uncertainties. They haven't been doing flood. They don't have access to as much data as they might have in the case of wind risk because they have been doing wind risk for a long time. But there has to be a starting place, and once companies get comfortable with—based upon the developments of the new models, I believe that they will—it won't be a rapid move into this marketplace, but it has to

start somewhere. And I think the more certainty we can bring to it, the more likely we are going to see this develop.

Chairman NEUGEBAUER. I thank the gentleman. My time has expired.

And now the vice chairman of the subcommittee, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I want to quickly ask a question of Mr. Brown here. I recognize that there have been concerns expressed about the consumer protections in private flood insurance. However, I think it is important to bear in mind that even as an insurer becomes insolvent, a State-guaranteed fund system would step in to provide policyholders support. Do you think consumers are better protected through the provisions included in H.R. 4558 or by private flood insurance generally than they are through the NFIP?

Mr. BROWN. Interesting question. I spoke with some folks back in Florida today to determine how we handle—how our Florida insurance guarantee fund would respond to flood claims. And what I have learned is, it confirmed what I thought I knew. But what I learned is that private offers of flood coverage, whether it is offered on an allied lines basis or as a part of a homeowners policy, is covered under our insurance guarantee fund in Florida if it is offered by an admitted carrier.

Mr. LUETKEMEYER. And it is a State-approved plan?

Mr. BROWN. It is a State-approved plan.

Mr. LUETKEMEYER. Okay. I would assume so. My guess is that—or, really, my question is, that provides the backstop, really, the State guarantee fund provides the backstop for an insurance solvency problem that could arise with a catastrophe of some sort that causes an insurance company to go belly up as a result of paying all the claims. And—

Mr. BROWN. That is correct.

Mr. LUETKEMEYER. —as long as you have taxpayers on the hook for an NFIP policy, that probably is not a concern. But the fact that we have a guarantee fund there would allay that one fear.

Mr. BROWN. That is correct.

Mr. LUETKEMEYER. I think it is a point we need to make. Okay. I am kind of concerned about—I am interested. This sounds like really good stuff, and I am really excited about the gentlemen from Florida and their work on the bill here. But I am kind of concerned, curious anyway, with regards to adverse selection. It would seem to me that the private sector would be ready to take on some of the less risky parts of the business. And something that is sitting in the middle of a hurricane or tornado belt of some sort would be where they want to stay away from. Is that something that concerns you? Is the modeling that goes on with the private companies here—are they taking that into consideration?

Are they just going to cherry-pick and then force all the worst pieces, or most exposed pieces of property into the government program. Which would mean those—they are going to—because of adverse selection have more risk there, and therefore more cost and raise the premiums accordingly?

Mr. BROWN. I think that is a reality. And, in fact, if you think about, originally—as government moved into the space—in Florida

we have had a lot of experience with Citizens Property Insurance Carrier, a company which took risk when there was not enough capacity in the marketplace. But government programs are really intended to take those risks as a facility of last resort. So—

Mr. LUETKEMEYER. So you are saying—excuse me for interrupting here. But you are saying, then, that you would see a continued need for the Federal Flood Program? That there wouldn't be a way to wean them out of this space here, and take it over completely by the private sector?

Mr. BROWN. I think in the foreseeable future, in the midterm, there is going to continue to be a need for some form of NFIP program until this transition can mature and develop. How long, I don't know. But I do believe that there are going to be some properties which may just simply not be economically—it doesn't make economic sense because they are receiving such a heavy subsidy now. We are probably trapped with some of those.

Mr. LUETKEMEYER. Okay. This is a hypothetical question, but do you see that by doing this—if the private sector cherry-picks all of the less exposed properties, and the more exposed properties are underwritten by the Federal Government—the Federal Government is, by the very inference, then, incentivizing building, or expanding your real estate holdings or whatever, in areas that are more prone to flooding, which would mean that they are incentivizing people to be able to do things in areas for which eventually, we as taxpayers, are going to pick up the tab.

Mr. BROWN. Unfortunately, that is a part of the original design of the NFIP program. Whether intended or not, when government creates a program, and they conspire if you will, to cloak the true cost of that program there are perverse incentives that are created. Price does far more than compensate a seller for his goods and services. It communicates valuable information about the appropriateness of human behavior.

Mr. LUETKEMEYER. One quick question, if I could indulge the chairman for a second. You talked about the rest of the world. Was it Mr. Gray who talked about the rest of the world, or Mr. Ellis, that there are insurance companies that insure other places in the world. And so are they doing that, as well? Are they cherry-picking everything, or are they insuring everything across-the-board, and accepting all the risks and underwriting accordingly?

Mr. ELLIS. At least in the studies that I have read, there are different models of how to do this. Whether it is a bundled policy, so it is within your homeowners insurance, and then it is laid-off risk to the private sector. Some of them have some government involvement. It is a whole bunch of different things. But there is enormous amount of appetite for risk in the catastrophe realm and for the re-insurance. And so, the marketplace is there. In the last 7 years, re-insurance rates, in an aggregate, have gone down. And so there is this amount of appetite for risk which is pushing some of this interest in getting into the marketplace.

And then just to your earlier comment, Congressman, I just want to add that most States have service in insurer's last resort, even on homeowners insurance. So there is always this sort of potential leftover that is going to be an issue. But I would also argue that would then concentrate the policymaker's mind, Congress' mind, on

dealing with some of these underlying issues and the subsidies because it isn't being masked by a lot of these property owners who are paying more they actually should, more than a market price, to be a part of the flood insurance program.

Mr. LUETKEMEYER. Very good. I appreciate the chairman's indulgence.

Thank you, my time is up.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Virginia, Mr. Hurt, is recognized for 5 minutes.

Mr. HURT. Thank you, Mr. Chairman.

Mr. Brown, I was intrigued by your last answers to the questions posed by Mr. Luetkemeyer, talking about the—what is built into the sort of structure of the National Flood Insurance Program to begin with, and how people are allowed to make decisions that may not make good economics. And I think at the heart of what we are talking about, really—that gets to the heart of it. And so I commend Representatives Ross and Murphy for putting this forward, and I am glad to hear your testimony today.

I guess my question, though—my first question would be, okay, so we know what the economic realities are, and risks are. But there is also a very real moral hazard that translates into—if you are encouraging somebody to live in a place that is dangerous, it is not just dollars and cents, it is not just insurance policies, it is not just insurance companies, it is not policyholders. You are encouraging them to do something that is risky to their life. And to the property. And I wonder if you could talk about that.

Mr. BROWN. Yes. Frederic Bastiat, in the middle 1800s, wrote a book entitled, "The Law." And in that book, he says this: "There is this common tendency among all people, when they can they choose to live and prosper at the expense of others." The essence of what he is getting at is that when you cloak the true cost of something you are depriving individuals of the signals that would otherwise cause them not to engage in that behavior.

And when government does that, they actually—it can rise to the extent that it creates a life safety issue. Yes, when someone hears that they can insure their property for \$1,000, and they move into a floodplain, they might make that decision a lot more cautiously if it were going to cost them \$10,000.

So there is no question that it has an effect on human behavior. In some cases, it is knowingly, and in some cases, the government is going to be blamed when there are life safety issues that arise and they said, well, I thought it was okay because the government subsidized my coverage.

Mr. HURT. Thank you. My next question would be to Mr. Ellis and Mr. Gray. I was wondering if you could talk a little bit about—we are talking about, because of the bill that has been—considering today will be forward-looking and reform going forward, I guess my question would be, how do we deal with the shortfall, the problem that we currently have? Can you talk a little bit about what you think that we can do to accelerate getting the program into the black? And if you—maybe, Mr. Ellis, I will start with you.

Mr. ELLIS. Thank you, Congressman. It is a big hole. You are talking right now—the last year, I think I mentioned in my testi-

mony, the premiums that came in were \$3.6 billion. You have a \$24 billion hole. Obviously, there are claims that are being paid; that the program hasn't actually reduced any of the debt since 2010. And that is owed with interest. And so, you are looking at an enormous hole. The borrowing authority, I think, is about \$30 billion after the additional funding that went in through Sandy so that it has room to borrow more. There was a surcharge in the bill.

I think it is—part of the reason that we opposed forgiving that debt, which was something that was being debated, is because it helps concentrate the mind. If you eliminated the debt, the program wouldn't change that much at all. And I think it is important to keep that there, and I think it is a challenge that we all are going to have to—I don't have any silver bullets in dealing with \$24 billion, and I didn't come here with \$24 billion in my pocket. So I think that is going to be a real challenge, going forward.

Mr. HURT. Thank you. Mr. Gray, quickly? In 30 seconds?

Mr. GRAY. Sure. I think it is mitigation and risk spreading, and trying to get the private market involved. And the sooner you can do that, then the better off our society is in handling the monster debt that we have right now.

Mr. HURT. Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Florida, Mr. Ross, one of the primary authors of this bill, is recognized for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman. We talk about the \$24 billion of debt that NFIP has. And it begs the question, if we are going to transition to a private market, is there sufficient capacity in the capital markets to do this? I will ask you, just going down the line, beginning with Mr. Ellis.

Mr. ELLIS. As I indicated before, there is an appetite for risk, particularly in the reinsurance markets. And there is an interest of insurance, and we saw that—for instance, in your State, Mr. Ross—when they—when you—right after Biggert-Waters there was an interest in trying to write flood insurance and growth in that marketplace. And so, clearly, there is an appetite for risk. How great that appetite is, it is not entirely clear. But there is definitely a significant appetite for that risk.

Mr. ROSS. Would you agree, Mr. Gray? As a broker, do you feel that there is sufficient capacity to meet the need at the NFIP?

Mr. GRAY. There is capacity out there, and lots of it. Now, how long that stays and what the pricing looks like, who can say? But right now—

Mr. ROSS. There definitely is. Would you concur, Mr. Brown?

Mr. BROWN. Yes.

Mr. ROSS. Now, Mr. Gray, you spoke on something just a second ago with regard to mitigation. And I think that is something that needs to really be addressed here. There are studies that have been done that for every one dollar of prevention in the mitigation, you save \$3 or \$4 from relief after the post-event relief. And I think that the NFIP has not been necessarily stellar in advocating mitigation. Let's face it, you get discounts in homeowners for storm shutters, you get discounts for ABS if you—in your automobile.

There are discounts that you—that the consumer gets as a result of mitigating any risk.

But that is more a function of not the private sector, would you not agree? And, I guess, Mr. Gray, what I want to ask you is, could you expound on how the private sector entering the market can impact the extent of greater mitigation in flood?

Mr. GRAY. Sure. Remember, insurance is only one piece of this puzzle that we have been looking at.

Mr. ROSS. Right.

Mr. GRAY. And you have mentioned some of those other pieces. The private market coming into, and appropriately pricing the risk would hopefully encourage homeowners and others who are involved in this process to take a look at what they can do to actually save on their premium dollars. And certainly, if the program is functioning properly—where there is more than just reinsuring the same risk over and over again, and suffering repetitive losses over and over again—then I think you will see some improvement in the properties, where people will abandon what becomes economically unfeasible properties.

Mr. ROSS. And economically, or actuarially speaking, would you say that there is more than one way to value risk?

Mr. GRAY. Well, sure.

Mr. ROSS. And, unfortunately, now you have only one valuation of risk that is being done, and that is by NFIP.

Mr. GRAY. Yes, it is whatever the government says that valuation is.

Mr. ROSS. Right. And then, supposedly, they are supposed to start sharing some of that with us. But we will see where that goes.

Mr. Brown, you are very familiar with the State regulatory schemes. I think McCarran-Ferguson has been good for the insurance markets. It has been very good for the consumers. And one of the things that State regulatory environments provide is strong consumer protections. Would you have any comments as to what would be in the benefit of the consumer in terms of protections if we were able to pass a bill such as this that allowed for the licensing of private carriers into the market?

Mr. BROWN. In particular with regard to claims paying, I think what happened in New Jersey is a lesson that we can learn. States have an extensive consumer protection in place. And they also have unfair claims practices in place which protect consumers for all coverages offered in that State except NFIP coverage.

Mr. ROSS. So if a consumer has a problem with an NFIP policy, they can't go to their State regulator. They have to go to NFIP and hope that they can get it resolved.

Mr. BROWN. That is correct. And I would tell you, from my experience as an agent, as a legislator, and as a lobbyist, that in Florida, in particular, regulators are very interested in doing what is right for consumers. If I had a flood policy in a floodplain, I would much rather rely upon my State regulator than having to go to the NFIP.

Mr. ROSS. I appreciate that.

Mr. Ellis, you spoke just briefly about the consumer protections. You also spoke about the grandfathering in. And I think the situa-

tion we are in is that if we were just starting fresh today, we would redesign how a private market should be able to cater to, and influence, behavior in terms of building and not building in high-risk areas. But since we are dealing with reality, and we are trying to wean people off of a government program, I agree with your assessment—in fact, I agree with Mr. Brown's assessment—that there must be a safety net in there that allows for the consumer to go back if it doesn't work out in the private market.

And if you would just expound on that in the few seconds that I have left, if you could.

Mr. ELLIS. Sure. It is just that—basically, just trying to clarify that if you went from the NFIP policy to what was deemed to be an equivalent private flood insurance policy, and then went back to NFIP or wanted to go back to NFIP, there wouldn't be interpreted a lapse in coverage as long as it was continuous. And so in that respect, I think it has that protection for the policyholders. It envisions that we are not going to get rid of NFIP tomorrow nor maybe should we, at this point.

Mr. ROSS. Right.

Mr. ELLIS. And so, I think that is just a recognition that you have to have.

Mr. ROSS. Thank you.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the other gentleman from Florida—one of the major sponsors of this piece of legislation, Mr. Murphy—is recognized for 5 minutes.

Mr. MURPHY. Thank you, Mr. Chairman.

Mr. Gray, just following up on Mr. Ross' comments there, do you think there is any reason to believe that the State insurance regulators need any help from Congress when so many other types of insurance are based at the State level? Do you see this as any different?

Mr. GRAY. No, I don't. I think State regulators are well able to take a look at the carriers and license holders that are within their borders and manage audits, and control and regulate those folks. Make sure that the citizens of the State are protected.

Mr. MURPHY. And can you tell me, in your opinion, how the mechanics of this would work at the State level in the context of private flood insurance? And whether you think State insurance regulators could assure that the private flood insurance policies provide no less coverage than that available through NFIP?

Mr. GRAY. I think it is important to understand what the idea of no less coverage means. And trying to create a cookie-cutter approach to that is not really how State regulators work. They take a look at the policy forms and the rates that are being charged, and take a look at the justifications that the carrier provides for those rates, and then make a determination, or ask questions, for future determination on the nature of that risk. And then ultimately, they approve or deny the rate regulation or form regulation.

Mr. MURPHY. And, I think, more to the point of each State being different, you have river flooding in Missouri and flash floods in Colorado and storm surges in Florida and sea level in Miami—we have a road, Alton Road, in Miami Beach, which is underwater all

the time now, I guess to the point here that the States are going to know best.

Mr. GRAY. That is absolutely correct. Certainly, the local jurisdictions are going to understand the nature of their risks within their borders better than somebody who is trying to fit a single approach to 50-some jurisdictions.

Mr. MURPHY. Okay. And, Mr. Brown, Biggert-Waters includes several provisions intended to encourage the development of the private flood insurance market. And the law also makes clear that private flood insurance should provide no less coverage than available through NFIP. In light of the sort of American system of insurance regulation, how do you make certain that the private insurance provides no less coverage—similar to what I asked Mr. Gray—than NFIP? And how does this process compare to what you do for homeowners policies and compliance?

Mr. BROWN. Okay. And some of the same answers apply here. And that is that when State regulators are allowed to certify on this, at the State level that coverage being offered in their State complies with the requirement that the coverage be similar to, and no less than, I believe there is the answer. They have the most knowledgeable team to make a determination as to whether or not somebody is trying to offer a stripped-down policy. What I think you are going to find is that companies who come to this marketplace are going to offer coverages that are not even available now under the NFIP.

For instance, if you have an above ground swimming pool at your home and the thing ruptures and water gets into your house, it is not covered under the NFIP policy. I think you will see enhanced coverages. And there is one exception to this, and I think—I want to be very clear. Coverages, in a traditional context, does not include deductibles. The ability to offer alternate deductibles is a management tool, a cost management tool, that has been used for decades by insureds and agents when recommending coverages.

So I would encourage you, when you make a final determination of what you want to do here, is to not tie States' hands on the ability of carriers in the private sector to offer alternate deductibles.

Mr. MURPHY. Good point.

Anybody can answer this. It relates to timing. One of my frustrations, especially with the Congress now, is that—the lack of clarity and certainty. If this were to be a logjam and nothing happens for 5 years, Mr. Gray, I think in your comments you alluded maybe to the point that this may disappear if we don't act soon. That this market, the private market may disappear. Is that what you were getting at, or do you think there is always going to be this market in the private sector?

Mr. GRAY. I think that we need to keep it moving. There is an appetite for the risk and there are some at least view within the insurer world that this is something that is an opportunity that they would be interested in writing. I want to make clear, though, when I say that State regulators are able to take a look at these risks and regulate them locally, I wholeheartedly believe that. But I also believe that regulation should be according to the State's purview of what is important rather than the Federal Government

telling the States you have to make this policy look like an NFIP policy.

Mr. MURPHY. Thank you.

Chairman NEUGEBAUER. If the gentleman has additional questions, I would yield him additional time.

Mr. MURPHY. I'm good.

Chairman NEUGEBAUER. Okay. I think Mr. Luetkemeyer had an additional question he wanted to ask.

Mr. LUETKEMEYER. Yes. Thank you, Mr. Chairman. Just one follow up for Mr. Ellis. Maybe I misunderstood what you were saying awhile ago, but you said something about mandatorily being forced to purchase health—or flood insurance. Can you explain what you are talking about there? Because I—

Mr. ELLIS. There is a—under existing law, there is a mandatory purchase requirement if you live in the special flood hazard area to purchase flood insurance. It is generally still what people call the 100-year floodplain or the 1 percent floodplain.

Mr. LUETKEMEYER. Right.

Mr. ELLIS. And so, that exists. It isn't, as I was indicating to the chairman, forced as much as they are saying. I think the estimates from GAO is as little as 50 percent of the people who should be purchasing flood insurance under the law are actually purchasing flood insurance that their lender should be requiring.

Mr. LUETKEMEYER. Okay. I understand what you are saying. But I would think that the regulators who look at the loans that the banks or credit unions or whoever are making would be the best judge of whether that actually needs to have flood insurance on it. Because you may just—you may have a half a million dollar home, but you may have a \$10,000 mortgage against it, sits in a floodplain. The lot is worth more than the—

Mr. ELLIS. I—

Mr. LUETKEMEYER. So there is no need for the flood insurance. I am not sure that I agree with your premise, unless you are talking about—

Mr. ELLIS. It is not my premise. It is just the law. I am just pointing out what the existing law is right now, which is there is a mandatory purchase requirement for high-hazard areas.

Mr. LUETKEMEYER. Okay, I guess—do you—with the private insurance market trying to take over, do you support continuing to have mandatory purchases of it when you could live in a floodplain, or you leave that up to the individual—

Mr. ELLIS. If you don't have a mortgage, you don't have to have it. The question is, are we protecting the—if you have a federally-backed mortgage, are we protecting the Federal Government in that context, as well. And so, I think it is an issue worth discussing about the mandatory purchase requirement. But at least in this context, I was just basically saying that if you purchase private flood insurance, that should meet your mandatory purchase requirement. Which has been one of the limitations in the past, is that it is not interpreted to actually meet that requirement.

Mr. LUETKEMEYER. Okay, thanks for your clarification.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman. I think one of the observations about increasing the take-up rate for private in-

insurance is, if we get the Federal Government actually charging actuarial rates would help do that, bring some competition to that process. So, I am hopeful.

I think we have had some great testimony here today. I want to thank the witnesses for their time and for their patience. I want to also thank Mr. Ross and Mr. Murphy for a very thoughtful piece of legislation. I think this is something that has bipartisan support, common sense. And while we may not be able to act on this in the 113th Congress, I would hope that this is something that we will work on in the 114th Congress.

I think there was—hopefully, there was not the thought that when we did that little adjustment to flood insurance, we had fixed flood insurance on a permanent basis. We have not, as the point—the fact that we still owe \$24 billion and have a \$30 billion line of credit.

And so, certainly, these discussions need to continue. I would also like to ask unanimous consent, without objection, to submit statements for the record from the American Bankers Association, the National Association of Mutual Insurance Companies, the Property Casualty Insurers Association of America, the Independent Insurance Agents and Brokers of America (Big “I”), the National Association of Professional Surplus Line Offices, and a letter from the Reinsurance Association of America.

Without objection, it is so ordered.

I would also like to thank the witnesses again.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, with no additional business, we are adjourned.

[Whereupon, at 4:01 p.m., the hearing was adjourned.]

# **A P P E N D I X**

November 19, 2014

The Subcommittee on Housing and Insurance

November 19, 2014 Hearing:

Opportunities for a Private and Competitive Sustainable Flood Insurance Market

Testimony of Don Brown

Chair Neugebauer, Ranking Member Capuano, and members of the subcommittee – thank you for having me here today. My name is Don Brown and I currently work as a lobbyist representing insurance and reinsurance companies in the state of Florida. Previously, I served in the Florida House for 8 years and I was an insurance agency owner for 28 years.

When the NFIP was established, flood was generally considered an uninsurable peril and few private companies were willing to write the risk. There was no loss history, no models for flood, and generally the insured knew much more about their potential for loss than the insurance company.

Flood is no longer an uninsurable risk and the private market is no longer unwilling to write flood. Just the opposite is true. There are several reasons for this development.

In the last few years, commercial flood models have been developed that, along with mapping and geocoding technologies, have given insurance companies a wealth of information regarding flood risk. There's been an influx of capital into the reinsurance and insurance arena – and that capital is interested in underwriting flood risk.

These developments provide new options for consumers when buying flood insurance.

Additionally, after the huge losses incurred by the NFIP during Hurricane Katrina and superstorm Sandy, it's become apparent that it's not necessary or desirable for the Federal government to take on all of the flood risk. It's better for U.S. taxpayers to have that risk borne by private companies – and it's better for consumers if they have options when buying flood insurance. Please see:

<http://nj.gov/governor/news/news/552013/approved/20130501c.html>

One additional consumer benefit to the development of a private flood market is that it is regulated by state insurance departments who have a long history of consumer protection as their very foundation.

As a former legislator, I believe the role of government is to remove obstacles to private companies and to give consumers additional options when insuring their homes. I believe there will always be a need for a program like the NFIP – but there's plenty of flood risk out there that can be written by private companies – and I can tell you that many of my clients are eager to write flood policies.

Unfortunately, insurance agents and banks have expressed concern with current Federal law that need to be addressed. Banks question if the flood policies written by private carriers will satisfy the mortgage requirement for homes located in a high-risk flood zone. Agents are concerned about E&O exposure for selling policies that might not meet the Federal mortgage requirement and the potential exposure if the agent sells a policy that negatively impacts the insured's ability to get subsidized NFIP coverage in the future.

There are at least three obstacles to a vibrant private flood market, however.

The first obstacle is that the law currently permits several different Federal agencies to regulate flood companies, and the policies they issue, to determine if those companies and policies satisfy the requirement to buy flood insurance for homes in high-risk zones with a federally backed mortgage. These agencies could issue different requirements, even years from now, that would throw the private market in to disarray.

Additionally, these Federal agencies would be superseding the states' role in regulating private insurance companies. This uncertainty is stifling the market for private flood insurance by creating uncertainty. H.R. 4558 addresses this problem by clarifying that if a company is approved by the insurance regulator of their domicile, then coverage is acceptable for homes located in a high-risk zone and with federally backed mortgages.

Please allow me to expand briefly on the notion that uncertainty can be an impediment to the formation of a healthy private flood insurance market.

What the flood insurance market needs more than anything else is: CAPITAL!

So, what are the impediments to Capital formation in this market space? To answer that question it might be helpful to reference Frank H. Knight's landmark book: *Risk, Uncertainty, and Profit* (1921). In his book Dr. Knight defined the difference between Risk and Uncertainty like this:

1. Risk is present when future events occur with measurable probability
2. Uncertainty is present when the likelihood of future events is indefinite or incalculable

When the probability of risk can be quantified there is a clear path forward. When uncertainty prevails and future events are indefinite or incalculable then the path forward is clouded and forward progress slows or, in extreme cases, stops altogether.

Dr. Knight goes on to explain that, in addition to uncertainty about our natural environment (in this case the weather), political and regulatory uncertainty can also impede private capital formation.

The following, now famous quote, expresses a concern over the unknown in a different way: "...there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know."—*Donald Rumsfeld*

How do people, including capital investors, weigh risk versus uncertainty? Consider a famous experiment that illustrates what is known as the Ellsberg Paradox. There are two urns. The first urn, you are told, contains 50 red balls and 50 black balls. The second one also contains 100 red and black balls, but the number of each color is unknown. If your task is to pick a red ball out of either urn, which urn do you choose? Most people pick the first urn, which suggests that they prefer a measurable risk to an immeasurable uncertainty. This condition is known to economists as ambiguity aversion, a kind of fear or paralysis in the face of the unknown or it could also be called “the inherent fear of the unknown.”

Today the greatest impediment to capital formation in the private flood market is political, legislative and regulatory uncertainty.

The second obstacle is that currently the law requires that private insurers offer coverage at least as broad as the NFIP for it to be accepted by banks. The issue is that “coverage” is defined by the law to include exclusions, conditions, and deductibles. Deductibles are not usually considered part of “coverage” when discussing a policy of insurance.

As someone who’s sold insurance policies for decades, I can tell you that when I discuss “coverage” with a customer – I’m usually talking about exclusions and conditions precedent – not the point at which the coverage attaches. The problem is that the way the law is drafted; it’s unclear if private companies can offer consumers additional options regarding deductibles and still have the policy considered to be comparable coverage to the NFIP and therefore accepted by the banking industry. The term “deductible” should be removed from the law so that consumers have a wide variety of options on how to structure deductibles when purchasing flood insurance.

The third obstacle is what I’ll call “grandfathering” of subsidized rates for NFIP consumers that go to a private carrier. H.R. 3370 that you all just passed clarified that the rate subsidy stays with the property – so even if a house is sold, the new owner gets the benefit of the same rate and glide path that the current owner had. Under current law, it’s not clear how the NFIP would rate a policy when a property moves from the NFIP to a private carrier and then wishes to come back to the NFIP. As an insurance agent, I can tell you that I’d be concerned about moving a customer from the NFIP to a private carrier if I wasn’t sure whether or not the customer would lose their subsidized rate should they want to return to the NFIP. Clarifying that a customer could return to the NFIP on the same glide path that they are currently on would make me feel more comfortable selling a private flood policy.

There is one additional “potential” obstacle – a new tax on global reinsurers. Testimony offered in November 2013 before this Subcommittee at a hearing on “The Future of Terrorism Insurance expressed concern over the Neal-Menendez bill, H.R. 3157. During that hearing Representative Ross asked Kean Driscoll, CEO of Bermuda-based Validus Re, the following question: “Would [H.R. 3157] limit the capacity or capability of insurers and reinsurers to take on more risk from terrorism or flooding (TRIA and NFIP) and thus be counterproductive to our long term goals of reducing the size of government insurance programs?” Responding Mr. Driscoll said: “Yes. Reinsurers need to be able to pool risk to gain diversification. Any limits on affiliate reinsurance would impede global risk pooling and would fragment group capital and would impede market development and likely *increase consumer prices* (emphasis added).” Notwithstanding the

unprecedented capital inflow to the global catastrophe market over the last several years, a new tax could mute that positive development.

In conclusion, I want to thank the committee for all the work they've done on flood insurance to date. Amazing progress has been made and I really do feel that there's an opportunity for a vibrant private flood market – there's just a few tweaks that need to be made to current law.

Thank you for your time and for inviting me to testify before you.

I'm happy to answer any questions you might have.



Testimony of Steve Ellis  
Vice President, Taxpayers for Common Sense

Subcommittee on Housing and Insurance  
Committee on Financial Services  
hearing

“Opportunities for a Private and Competitive Sustainable Flood Insurance Market”

November 19, 2014

Good afternoon, Chairman Neugebauer, Ranking Member Capuano, members of the subcommittee. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog. Thank you for inviting me here today to testify on H.R. 4558, the “Flood Insurance Market Parity and Modernization Act of 2014” and issues involving a private flood insurance market.

*Background on the National Flood Insurance Program*

After years of ad hoc disaster aid being meted out by Congress, the National Flood Insurance Program (NFIP) was established in 1968 to create “a reasonable method of sharing the risk of flood losses through a program of flood insurance which can complement and encourage preventative and protective measures.”<sup>1</sup> The program was to make up for a lack of available flood insurance. But even at that time Congress was warned that it was playing with fire. The Presidential Task Force on Federal Flood Control Policy wrote in 1966:

A flood insurance program is a tool that should be used expertly or not at all. Correctly applied it could promote wise use of flood plains. Incorrectly applied, it could exacerbate the whole problem of flood losses. For the Federal Government to subsidize low premium disaster insurance or provide insurance in which premiums are not proportionate to risk would be to invite economic waste of great magnitude.<sup>2</sup>

Well, we know which way that story unfolded. Although subsidies were largely envisioned to be limited and short-term, they weren’t. And while the program has encouraged standards and

<sup>1</sup> P.L. 90-448.

<sup>2</sup> U.S. Task Force on Federal Flood Control Policy. “A Unified National Program for Managing Flood Losses.” August 1966. P 17. <http://www.loc.gov/law/find/hearings/floods/floods89-465.pdf>

construction that help reduce flood risks for participating communities, the availability of subsidized federal flood insurance over the last several decades made it financially attractive to develop in high risk areas. Along with other factors, NFIP helped fuel the coastal development boom that increased the program's risk exposure and losses.

*\$24 Billion in Debt and Subsidized Rates*

For years NFIP teetered on either side of solvency, covering shortfalls with Treasury borrowing and repaying the loans in years of surplus. Then in 2005, the inevitable happened – a catastrophic loss year – and the program was roughly \$18 billion in debt to the Treasury. That was followed by the Superstorm Sandy losses in 2012 and now the program is more than \$24 billion in debt to taxpayers. To put that in perspective, FEMA data indicates that in 2013 the 5.6 million policies resulted in \$3.5 billion in premium to insure \$1.3 trillion worth of property.<sup>3</sup> The Government Accountability Office has estimated that approximately 20 percent of policies are explicitly subsidized and paying only 35-45 percent of their actual full-risk level premiums.<sup>4</sup>

As this Subcommittee well knows, reforms to the NFIP were enacted in 2012 to increase premiums to more risk-based rates, which would not only help program solvency, but also help policyholders better understand their risk and take measures to mitigate that risk. Despite some concerns, TCS supported the 2012 legislation while also favoring additional efforts to help address affordability issues. Unfortunately, earlier this year Congress reacted to a vocal minority and largely rolled back the 2012 reforms that would have led to more actuarial rates.

*Private Flood Insurance*

To obtain a mortgage, property owners in designated special flood hazard areas (typically those with one percent chance of flooding in any given year) are required to purchase flood insurance. As long as it met NFIP coverage standards (enough insurance to cover property value or maximum coverage amount of \$250,000, whichever is less) private flood insurance could be an alternative to federal flood insurance to meet the mandatory purchase requirement. As the shift to more risk-based rates under the reform neared, the private market started to strengthen. States like West Virginia and Florida enacted legislation to regulate new private flood insurance alternatives in their states.

However the 2012 flood insurance bill went further than before and attempted to quasi-regulate what exactly constituted private flood insurance by including a proviso that private flood insurance be “at least as broad” and essentially mirror an NFIP policy. This will result in lenders rejecting some private policies as not meeting legal requirements. For example, homeowner may want to purchase a higher coverage limit with a higher deductible than is available under the NFIP. Current law would result in that policy being rejected by the lender as not meeting the legislated “private flood insurance” definition.

<sup>3</sup> Federal Emergency Management Agency. Available at: <https://www.fema.gov/statistics-calendar-year>

<sup>4</sup> Government Accountability Office. “Flood Insurance: More Information Needed on Subsidized Policies.” July 2013.

The whole point of allowing a private insurance alternative is to create competition and choice in the marketplace and reduce the possible burden on the taxpayer. Furthermore, insurance is regulated at the state level. The federal government leaves decisions on homeowners insurance and car insurance to states; they should do the same for private flood insurance alternatives.

This is why Taxpayers for Common Sense supports H.R. 4558, the "Flood Insurance Market Parity and Modernization Act of 2014." This legislation would remove the restrictive and confusing language and define private flood insurance as an insurance policy that is issued by an insurance company that is licensed or approved in the State where the property is located. This does not remove the mandatory purchase requirement and minimum coverage level. This just allows insurance commissioners to regulate the product in their state the way it is done for other insurance lines. One recommendation that TCS has would be clarify that if a homeowner opts for uninterrupted coverage through a private policy, the homeowner should not be treated as having a 'lapse' in coverage under NFIP. This would allow a homeowner to return to the NFIP, if they desire, without penalty.

The only reason a policyholder will opt for private insurance over NFIP is because the private insurance offers a better product, a better price, or both. To stifle the private market would be akin to the federal government forcing policyholders to pay more.

#### *Barriers to Private Flood Insurance*

In addition to the definitional issue, the existence of subsidized federal flood insurance is a barrier to the development of a robust private market. Simply put, NFIP occupies the space where the private sector would operate. It is true that NFIP was created because there wasn't a functioning private insurance marketplace, but that was nearly fifty years ago. It almost goes without saying that technology and modeling have advanced dramatically. Imagery and mapping technology has similarly developed. The reinsurance and financial instruments to manage risk are much larger and more diversified.

Many countries in the world have private flood insurance either bundled into property insurance or as separate or add-on coverage. These are typically backed by reinsurance. In fact, the U.S. is one of the only countries with a state-backed separate policy of flood insurance.<sup>5</sup>

#### *Conclusion*

The development of a private flood insurance market in the United States would serve to shift some of the post-disaster recovery and rebuilding burden from taxpayers to the private sector and those who choose to live in high risk areas. It could also be a powerful tool to encourage mitigation in the face of increased disasters and sea level rise. The National Flood Insurance Program is \$24 billion in debt to the taxpayer. While the decision to repeal many of the 2012 reforms was a setback, Congress can enact H.R. 4558 to at least help private flood insurance have a chance.

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<sup>5</sup> Jessica Lamond, Edmund Penning-Rowse. Climate Risk Management. "The Robustness of Flood Insurance Regimes Given Changing Risk Resulting from Climate Change." March 29, 2014.



**November 19, 2014**

**Testimony of Jordan N Gray *on behalf of* WNC Insurance Services, Inc.**

**House Financial Services Committee, Subcommittee on Housing and Insurance,  
Hearing on “Opportunities for a Private and Competitive Sustainable Flood  
Insurance Market”**

Chairman and members of the Subcommittee: thank you for the opportunity to testify before you today. My name is Jordan Gray. I am Senior Vice President and General Counsel of WNC Insurance Services, Inc. My testimony today is on behalf of my company, WNC Insurance Services. WNC is an independent Property and Casualty Insurance Agency/Broker, Surplus/Excess Lines Agent/Broker, MGA/MGU, and Lloyd's of London coverholder.

**WHO IS WNC?**

Wilshire National Corporation was founded in 1962 as a captive insurance agency owned and operated by Larwin Corporation, a large national homebuilder and community developer.

WNC Insurance Services, Inc. (WNC), the successor to Wilshire National Corporation, was incorporated in California in 1975. Since that time, WNC has operated as an independent managing general agent, managing general underwriter, program administrator, surplus lines broker and property and casualty agent.



In the 1980s WNC began providing flood coverage auditing of loan portfolios for mortgage lenders performed to determine the existence and adequacy of required flood insurance as well as to promote insurance programs designed for commercial lenders.

In 1991, WNC added voluntary flood insurance to its product offerings, specifically excess flood insurance – substantially expanding its business opportunities in the Voluntary and Broker Agency distribution channels.

In 2001, WNC acquired First Guaranty Companies, a leading provider of collateral protection products for community lenders nationwide.

Today, WNC serves nearly 3,000 small and mid-market community banks and credit unions, hundreds of independent agents and brokers, and thousands of homeowners and businesses, providing Lender Placed Insurance; Insurance Outsourcing Services; and Private Flood Insurance.

WNC has relationships with insurance carriers rated "A" or better by A.M. Best such as American Modern Insurance Group, Chubb Group of Insurance Companies, Great American Insurance Company, and Philadelphia Insurance Companies. WNC is one of the larger Flood and Excess Flood Coverholders at Lloyd's of London.

#### **WHY IS WNC TESTIFYING?**

There are two points WNC would like to make regarding its testimony.

First, WNC is grateful for the National Flood Insurance Program. Not just for the obvious reason that WNC, its employees, and its network of insurance agents and brokers support their families by providing insurance products and services in this industry, but because the country would still be struggling with the question of whether flood insurance is a viable product. The National Flood Insurance Program is the



entrepreneurial catalyst that created an important industry, that is now ready for the next phase of its growth and evolution -- privatization.

Second, WNC is grateful for the Biggert-Waters Flood Insurance Reform Act of 2012. The Biggert-Waters Act is evidence that both sides of the aisle can work together to provide constructive solutions to the difficult problems facing our nation. We are pleased with this idea.

WNC is here today to express its support for H.R. 4558 - The Flood Insurance Market Parity and Modernization Act of 2014. It's a simple bill that provides an appropriate fix to an unintended consequence of Biggert-Waters Flood Insurance Reform Act.

#### **WHAT IS THE PROBLEM?**

One of the unintended consequences of Reform Act is that it makes it more difficult for lenders to accept private flood insurance in satisfaction of the mandatory purchase of flood insurance requirement, thereby impeding the long established public policy goal behind both the Flood Disaster Protection Act of 1973 and the Biggert-Waters Flood Insurance Reform Act of 2012 -- *private market involvement in flood insurance*.

One of the positive results of Biggert-Waters is that it settles an age-old debate -- can a lender accept a private flood insurance policy in satisfaction of the mandatory purchase obligations under federal law. The answer is yes -- always has been, and now a lender must accept a private policy. Thankfully, Biggert-Waters finally ended this debate.

Unfortunately, the Reform Act has created a new debate -- what is private flood insurance? While we at WNC believe the Legislators were well meaning, language from the FEMA Mandatory Purchase of Flood Insurance Guidelines became the law. Yet, even FEMA has never taken the position that its Guidelines should become the law of the land, or that the Guidelines were ever written to hold that esteemed position.



What was intended to liberate both borrower and lender alike has now placed them in a straight-jacket of regulatory compliance, mandating that bankers become insurance professionals and that insurance professionals become bankers. Meanwhile, banking regulators and insurance regulators have begun their struggle with the unenviable job of sorting out insurance requirements from banking requirements, leaving these industries in confusion.

So, what does this confusion look like -- here's an example?

When a loan is about to close, there is a mandatory purchase obligation if the property is located in a Special Flood Hazard Area. The borrower is told to purchase flood insurance. The borrower approaches an insurance agent or broker to obtain the policy. But the problem is that the federal flood policy only provides \$500,000 of coverage for the \$5,000,000 building at risk. So the borrower purchases a private flood policy. The carrier and broker are certain that this private policy is exactly what the borrower needs.

The borrower takes the policy to the lender to close the loan, but the compliance department tells the borrower that it cannot accept this private policy if it doesn't follow the National Flood Insurance Program, General Property Insurance Form, exactly as written. In fact, if the policy is an addendum to a multi-million dollar hazard insurance policy covering this borrower's other properties, none of which are located in a special flood hazard area, it's definitely not acceptable, the compliance department says.

Although the policy provides better coverage with more policy benefits, it doesn't have a matching cancellation clause. Thus, real or imagined, the lender's compliance department insists that the policy doesn't comply with the new law. Now the borrower must purchase three policies instead of one, just for this one property and the goal of the law is frustrated -- where is the private market involvement? Frustrated.



The lender is frustrated because it knows that it must comply with the regulations or face potential fines and penalties, but doesn't really have the expertise to tell if the policy truly is a good one. The borrower is frustrated because it cannot purchase the product it wants and cannot close the loan on time. The carrier and agent are frustrated because they have a perfectly good product that fails to meet a perceived or actual technical definition of private flood insurance, but yet the policy will perform as good as or better than the federal policy when a loss occurs.

Moreover, the reputation of the carrier and the agent are questioned -- "I thought you said this policy is exactly what I need, yells the borrower?" The broker and carrier write urgent letters explaining that the policy is good, the carrier is sound, and the coverage is compliant. The pleas are to no avail because the cancellation clause doesn't match FEMA's Standard Flood Insurance Policy, General Property Form, as required by the Reform Act.

We at WNC cannot believe that this was the intended consequence of the Reform Act.

#### **WHAT IS THE SOLUTION?**

The solution is simple – give private insurance carriers and brokers, state insurance regulators, federal banking regulators, lenders and borrowers, the same discretion to evaluate flood insurance as they have to evaluate all other insurance. H.R. 4558 - The Flood Insurance Market Parity and Modernization Act of 2014 does this.

The proposed bill will encourage greater private market participation in the business of flood insurance and it will likely help facilitate the transfer of a greater portion of overall flood risk from an overburdened government program to private carriers.

The private insurance industry is in the business of providing critical insurance protection to consumers and businesses across the country. Why should flood



insurance be treated any differently than other types of insurance? Is it because of the catastrophic nature of flood losses? What about wind insurance covering tornado and hurricane losses -- are not these catastrophic losses? What about earth quake coverage, which generally isn't even a coverage required by lenders? It is a good thing to require flood insurance, but let the private insurance industry do its job managing it.

Private insurance companies are interested in this risk and will provide valuable private flood insurance coverage to a willing market if regulatory oversight is brought into a balanced perspective on this issue. The insurance industry has a long history of offering vital coverage to policy holders in their time of need. HR 4558 provides a balanced market and regulatory perspective by removing a regulatory straight jacket that serves no real purpose. Flood is not unique; it is one of many perils that private insurers are well equipped to handle.

In fact, many large commercial businesses, resorts, hotels, and other properties have purchased private flood insurance under multi-peril policies offered by private insurance carriers for years -- often in amounts far in excess of what would be available from the National Flood Insurance Program.

#### **CONCLUSION**

There is a vital private market waiting to provide flood insurance. There is a hopeful lending market looking for some regulatory relief. There are capable insurance regulators and banking regulators that would be greatly benefited if they were guided back into their areas of expertise. There are eager policy holders looking forward to quality coverage becoming widely available in the private market. HR 4558 -- Flood Insurance Market Parity and Modernization Act of 2014 is the next step.

Thank you again for the opportunity to testify on this important issue. I look forward to your questions.

*November 18, 2014*

**Statement for the Record**

*On behalf of the*

**American Bankers Association  
And  
American Bankers Insurance Association**

*before the*

**Committee on Financial Services**

*of the*

**United States House of Representatives**



November 18, 2014

**Statement for the Record**  
*On behalf of the*  
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November 18, 2014

Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee, the American Bankers Association and its insurance affiliate, the American Bankers Insurance Association, appreciate the opportunity to submit for the record comments on H.R. 4558, the Flood Insurance Market Parity and Modernization Act of 2014. ABA is the voice of the nation's \$14 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits, and extend nearly \$8 trillion in loans.

ABA has long supported reform of the National Flood Insurance Program (NFIP). Concerns about the actuarial soundness of the NFIP and the ever-increasing cost to the U.S. Treasury of providing federal disaster relief to the uninsured necessitate reforms that promote the development of a competitive and sustainable flood insurance market, increase the availability and affordability of coverage for all at-risk properties, and eliminate compliance burden.

Congress made clear that private flood insurance should be an available alternative to the NFIP. Efforts to provide clarity, such as the passage of Section 100239 of the Biggert-Waters Flood Insurance Reform and Modernization Act of 2012, have become hopelessly bogged down in implementation and have inadvertently acted to *reduce* private sector involvement rather than promote it. Unfortunately, the result has been to leave the U.S. Treasury holding virtually all the flood risk through the NFIP.

Further clarification and guidance is sorely needed. H.R. 4558, introduced by Rep. Dennis Ross (R-FL), provides a clear and elegant solution to effectuate the intent of Congress to support private insurance as an alternative to the government's NFIP. ABA supports this logical and

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efficient bill. Over time, we believe that increased private-sector participation will expand the flood insurance options available to property owners, lower costs, and increase the number of insured at-risk properties with flood insurance—all of which will limit the federal government’s exposure to flood loss.

#### I. Private Sector Flood Insurance Has Been Discourage By Implementing Guidance

Since the passage of the National Flood Insurance Act of 1968, private flood insurance has been understood to satisfy requirements and mandates to purchase flood insurance. In practice, however, guidance issued by FEMA and the federal regulatory agencies assigned to implement the flood laws (the Agencies) has encouraged the acceptance of private flood insurance only when NFIP coverage is unavailable, when a private policy is used to supplement NFIP insurance, or to fill a gap in coverage in the period of time before a force placed policy takes effect. The guidance has *discouraged* the acceptance of private flood policies when the mandatory purchase requirement applies, that is when a property is located in a flood zone.

FEMA’s 2007 *Mandatory Purchase of Flood Insurance Guidelines* states:

When private flood coverage is being considered in lieu of an NFIP policy, a lender should understand and comply with FEMA’s criteria (described below) for selection of the private insurer and the form of coverage.

A private flood insurance policy that meets all six of the FEMA criteria described in a. through f. below conforms to the mandatory flood insurance purchase requirements of the 1994 Reform Act. **To the extent that the private policy differs from the NFIP Standard Flood Insurance Policy (SFIP), available on the FEMA website at <http://www.fema.gov/business/nfip/sfip.shtm>, the differences should be carefully examined before the policy is accepted as sufficient protection under the law.** [emphasis added]

The six criteria identified by FEMA include requirements for: licensure of the insurance carrier, cancellation/non-renewal notices, “breadth of policy coverage,” strength of the mortgage interest clause, and legal recourse. Significantly, the enumerated requirements are not dictated by law; instead, they simply describe the provisions of a standard flood insurance policy under the NFIP. In practice,

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compliance with this guidance imposes a uniformity that discourages the development of alternative private flood insurance policy options, inhibiting competition and the growth of the private market.

Echoing FEMA's guidance, in 2009 the Agencies published *Interagency Questions and Answers on Flood Insurance* which state:

Question #63: May a lender rely on a private insurance policy to meet its obligation to ensure that its designated loans are covered by an adequate amount of flood insurance?

Answer: It depends. A private insurance policy may be an adequate substitute for NFIP insurance if it meets the criteria set forth by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines*. Similarly, a private insurance policy may be used to supplement NFIP insurance for designated loans where the property is underinsured if it meets the criteria set forth by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines*. FEMA states that, **to the extent that a private policy differs from the NFIP Standard Flood Insurance Policy, the differences should be carefully examined before the policy is accepted as sufficient protection under the law.** FEMA also states that the suitability of private policies need only be considered when the mandatory purchase requirement applies. [emphasis added]<sup>1</sup>

The task of conducting the required comparison between a private flood insurance policy and an NFIP policy across each of the six criteria has been challenging for bankers, who it is important to note, are not insurance experts. There is no "standard" private flood policy. Many private flood policies are surplus lines insurance policies that have tailored coverage and pricing to fit the risk; therefore, the coverage and forms do not mirror those of a standard NFIP policy. Other private policies are admitted products, but because they are designed by their carriers *to compete* with NFIP policies by offering greater limits, broader coverage, or more coverage features, their coverage and forms also differ from an NFIP policy.

As a result of these differences, each policy must undergo a time consuming review by compliance employees who may struggle to even *identify* sections of the private policy that are relevant to the six criteria and then are further challenged to assess the comparability of the coverage. Invariably, questions arise with respect to one or more of the six criteria, requiring additional review by an attorney who must exercise discretion in judging whether the bank can accept a particular provision that does not match up with FEMA's criteria. This review can take hours—all for a policy that provides the same or

<sup>1</sup> Interagency Questions and Answers on Flood Insurance, Q & A #63, 74 Fed. Reg. 35914, 35944 (July 21, 2009), available at <http://www.gpo.gov/fdsys/pkg/FR-2009-07-21/pdf/E9-17129.pdf>.

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more extensive coverage than an NFIP policy and assures that neither FEMA nor the federal government will be liable for flood loss. Moreover, insistence on such an evaluation by a bank ignores the fact that a *licensed and expert* insurance agent – charged with a duty to act with reasonable care to the client – has represented to the borrower/property owner that the policy provides sufficient flood insurance protection in compliance with the law.

These challenges have led some large banks to hire insurance professionals to conduct the analysis and to document decisions to accept a “non-conforming” policy that the bank has concluded from a safety and soundness risk perspective adequately protects the borrower and the bank in the event of a flood loss. However, even large banks worry that examiners will criticize these judgments.

Community banks, lacking similar resources and expertise on staff, typically refuse to accept anything other than an NFIP policy. Likewise, most bank examiners lack the necessary expertise to do the side-by-side comparison and have encouraged community bankers to accept only NFIP policies to satisfy the mandatory purchase requirement. Moreover, all banks are uncertain about whether a multiple peril policy can satisfy the regulatory minimums, and efforts to have FEMA or the Agencies provide definitive guidance have been unsuccessful.

The effect of the guidance, over time, has been to limit private sector involvement in the flood insurance market and to impose virtually all flood risk on the U.S. Treasury through the NFIP.

## **II. Implementation of Biggert-Waters Act Section 100239 will Further Limit Private Sector Participation in the Management of Flood Insurance Risk**

The 2012 reauthorization of the NFIP presented Congress with the opportunity to address this problem. Accordingly, section 100239 of the Biggert-Waters Act amends the mandatory purchase requirement and *requires* lenders to accept a private flood insurance policy as satisfaction of the mandatory purchase requirement, if the coverage provided by the private policy meets standards specified in section 100239’s definition of “private flood insurance.”<sup>2</sup> Unfortunately, by

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<sup>2</sup> Section 100239 amended 42 U.S.C. §4012a, adding the following definition of “private flood insurance:”

(7) In this subsection, the term ‘private flood insurance’ means an insurance policy that—

(A) is issued by an insurance company that is—

(i) licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the insured building is located, by the insurance regulator of that State or jurisdiction; or

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codifying the six criteria from FEMA's 2007 *Mandatory Purchase of Flood Insurance Guidelines* as dispositive of whether a private policy satisfies the mandatory purchase requirement, the statute mandates the analysis that has proved so challenging for lenders. Furthermore, if an examiner later disagrees with a bank's decision to accept or reject a private policy, the bank may be assigned civil money penalties in the amount of \$1000 per violation.

Thus, section 100239 frustrates the intent of Congress and makes widespread acceptance of private flood insurance even less likely than in the past. Indeed, our members are concerned that if implemented, section 100239 could require banks to reject *existing* private policies that were accepted by the bank exercising the discretion to accept a policy that deviates from one or more of the criteria but provides sufficient flood insurance protection in compliance with the law. Thus, section 100239 has increased the risk of accepting a private flood insurance policy, which in turn threatens to limit the development of a competitive and sustainable private flood insurance market. (Attachment A describes three scenarios in which a bank that might have exercised discretion to accept a private policy would be forced to reject that policy if section 100239 is implemented as drafted.)

Aware of these issues, the Agencies—charged with implementing section 100239—proposed a safe harbor for private flood insurance policies. Under the proposed safe harbor, a private policy would be deemed to meet the statutory definition of private flood insurance if a state

(ii) in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction where the property to be insured is located;

(B) provides flood insurance coverage which is at least as broad as the coverage provided under a standard flood insurance policy under the national flood insurance program, including when considering deductibles, exclusions, and conditions offered by the insurer;

(C) includes—

(i) a requirement for the insurer to give 45 days' written notice of cancellation or non-renewal of flood insurance coverage to—

(I) the insured; and (II) the regulated lending institution or Federal agency lender;

(ii) information about the availability of flood insurance coverage under the national flood insurance program;

(iii) a mortgage interest clause similar to the clause contained in a standard flood insurance policy under the national flood insurance program; and

(iv) a provision requiring an insured to file suit not later than 1 year after date of a written denial of all or part of a claim under the policy; and

(D) contains cancellation provisions that are as restrictive as the provisions contained in a standard flood insurance policy under the national flood insurance program."

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insurance regulator makes a determination, in writing, that the policy meets the definition of private flood insurance.

In comments filed in December 2013, ABA supported the proposed safe harbor, which would permit a lender to rely upon the expertise of state insurance authorities to make the necessary determinations as the adequacy of a private flood policy. As a practical matter, however, we pointed out that no such mechanism exists today for state insurance authorities to make that determination, and it could be some time before such a mechanism is implemented. Moreover, even if such a mechanism is developed, it may not be implemented in the same manner in each state since each state retains independent authority over the business of insurance conducted within its borders.<sup>3</sup>

### III. H.R. 4558 Provides a Simple Solution to the Private Flood Insurance Issue

It has been eleven months since the comment period closed, and the Agencies have not published final regulations implementing section 100239. It is abundantly clear that implementing a workable regulation under 100239 cannot be achieved. It will only add even more layers of confusion and compliance obligations that will further discourage any private sector involvement.

Therefore, ABA urges the Congress to enact H.R. 4558. The bill provides a simple and clear definition of private flood insurance that satisfies the mandatory purchase obligation. H.R. 4558 would define acceptable "private flood insurance" as a policy that—

- A. provides flood insurance coverage;
- B. is issued by an insurance company that is—
  - i. licensed, admitted, or otherwise approved to engage in the business of insurance of the State or jurisdiction in which the insured building is located, by the insurance regulator of that State or jurisdiction; or
  - ii. eligible as a nonadmitted insurer to provide insurance in the State or jurisdiction where the property to be insured is located, in accordance with sections 521 through 527 of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and
- C. is issued by an insurance company that is not otherwise disapproved as a surplus lines insurer by the insurance regulator of the State or jurisdiction where the property to be insured is located.

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<sup>3</sup> Therefore, ABA recommended the establishment of an additional, or alternative, path to a safe harbor based upon an endorsement or written certification issued by the carrier issuing the private policy that the policy meets the definition of "private flood insurance" in the statute.

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ABA believes that H.R. 4558 properly recognizes and defers to the existing state regulatory scheme for insurance. Private insurance carriers are subject to statutes and regulations in each and every state. State insurance commissioners are the appropriate regulator to allow or disallow any policy they deem improper, and they have significant authority to assure fair and equitable settlement of claims.

H.R. 4558, if enacted, would encourage the development of a competitive and sustainable private flood insurance market. In addition, it will avoid the market disruption that may ensue if section 100239 is implemented. Many private policies available today and for the foreseeable future do not meet all of the requirements of section 100239's definition of "private flood insurance." Many lenders already have accepted private flood insurance policies, and lenders and borrowers will need to continue to accept private flood policies to meet the statutory mandate until insurers can elect to incorporate (or not) the model language in their policies.

Thus, H.R. 4558 solves a material problem that, if left unaddressed, will cause disruption in the market place and will frustrate achievement of one of the underlying goals of Biggert-Waters: "increase[ing] the role of private markets in the management of flood insurance risk"<sup>4</sup> and reducing reliance on federal flood insurance policies and the risk they impose on the U.S. Treasury.

#### **Conclusion**

The American Bankers Association and the American Bankers Insurance Association appreciate the opportunity to submit this statement. We commend the continued attention paid to the issue of providing private alternatives to the NFIP by the Congress, and the Financial Services Committee in particular.

Congress has already made clear that private insurance should be an available alternative to the NFIP, but the mechanics of ensuring that such coverage is available and utilized have proven complicated. The intersection of state regulation of insurance broadly, federal regulation of the NFIP, and bank compliance examination have made it clear that further clarification and guidance is needed. H.R. 4558 provides a clear and elegant solution to the questions that have arisen. We commend Representative Ross for his efforts and urge support for this logical and efficient approach to address the complications that have thus far inhibited more private insurance alternatives to the NFIP.

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<sup>4</sup> H. Rep. No 112-102, at 1 (2011)

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#### Attachment A

##### Private Policy Scenarios

The following scenarios could be viewed as “acceptable” under prior guidance, but would not conform to Biggert-Waters Act section 100239:

##### Scenario 1

###### Facts

Customer pledges a single property, containing four commercial structures located in a Special Flood Hazard Area (SFHA) as collateral for a loan. The customer obtains a master blanket hazard insurance policy to cover all properties they own (which are numerous and go far beyond the collateral for this particular loan). This policy allots a lump sum of coverage for the peril of flood to all buildings covered by the policy. The limit of coverage for flood losses is greater than \$2MM, however it is significantly less than enough to cover all the buildings it applies to. The policy carries a “per occurrence” deductible, rather than a “per building” deductible, of \$500,000. Additionally, the policy settles losses for commercial structures on a replacement cost value basis, rather than actual cash value as would be the case with a NFIP policy.

###### Rationale for accepting this policy under pre-BWA guidance

The lender can examine the building schedule associated with the policy (if available) to determine whether the structures are concentrated in a particular geographic area. If they are not, the risk of numerous structures suffering flood losses in the same policy year is considerably lower. Additionally, while the deductible limit is high, it would not apply to each individual structure if a flood loss occurred at the location of the collateral securing the loan (four structures, same location, greater likelihood they would all flood). Lastly, the fact this policy settles losses on a replacement cost value basis is an improvement from what the property owner could obtain from the NFIP.

###### Why this policy would not conform to BWA

Multiple factors do not conform to the Breadth of Coverage threshold

##### Scenario 2

###### Facts

Customer provides a policy that is generally consistent with the FEMA criteria, however it covers three perils that all pull from an aggregate limit of coverage. Additionally, the policy contains a recourse period longer than 1 year.

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Rationale for accepting this policy under pre-BWA guidance

The lender may ask the borrower to increase coverage beyond 100% RCV to account for the two additional perils. The lender would also likely view the additional recourse period as a benefit.

Why this policy would not conform to BWA

- The tri-peril aspect of the policy would not conform to the Breadth of Coverage threshold.
- The protracted recourse period would not conform to the Legal Recourse threshold.

**Scenario 3**

Facts

Customer provides a policy that will provide coverage that is more robust than the coverage obtained under the NFIP. However, the policy includes a cancellation/non-renewal period of less than 45 days, and the cancellation/non-renewal clause does not include notice to Mortgagee. Additionally, the policyholder can cancel the policy at any time without the consent of the Mortgagee.

Rationale for accepting this policy under pre-BWA guidance

If the policy is otherwise sufficient and contains provisions that are more robust than coverage obtained under the NFIP, the lender may elect to accept this coverage if they have a strong monitoring process in place to mitigate the risk associated in the event of insurance agency failure to notify the Mortgagee of non-renewal.

Why this policy would not conform to BWA guidance:

- Policy does not conform to the Requirement of 45-day Cancellation/Non-Renewal Notice threshold.
- Policy does not conform to Strength of Mortgagee/Interest threshold.



**STATEMENT BEFORE THE  
COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON HOUSING AND INSURANCE  
UNITED STATES HOUSE OF REPRESENTATIVES**

**November 19, 2014**

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The Big “I” is the nation’s oldest and largest trade association of independent insurance agents and brokers. We represent a nationwide network of more than a quarter of a million agents, brokers and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium and large businesses offer all lines of insurance – property/casualty, life, health, employee benefit plans and retirement products. In fact, our members sell 80% of the commercial property/casualty market and a sizeable portion of the homeowner’s market. It is from this unique vantage point that we understand the capabilities and challenges of the insurance market when it comes to insuring against flood risks.

***Background***

The Big “I” believes that the National Flood Insurance Program (NFIP) provides a vital service to people and places that have been hit by a natural disaster. The private insurance industry has been, and continues to be, largely unable to underwrite flood insurance because of the catastrophic nature of these losses. Therefore, the NFIP is virtually the

only way for people to protect against the loss of their home or business due to flood damage. Prior to the introduction of the program in 1968, the federal government spent increasing sums of money on disaster assistance to flood victims. Since then, the NFIP has saved disaster assistance money and provided a more reliable system of payments for people whose properties have suffered flood damage. It is also important to note that for almost two decades, up until the 2005 hurricane season, no taxpayer money had been used to support the NFIP; rather, the NFIP was able to support itself using the funds from the premiums it collected every year.

Under the NFIP, independent agents play a vital role in the delivery of the product through the Write Your Own (WYO) system. Independent agents serve as the sales force of the NFIP and the conduits between the NFIP, the WYO companies and consumers. This relationship provides independent agents with a unique perspective on the issues surrounding flood insurance, yet also makes the role of the insurance agent in the delivery process of flood insurance considerably more complex than that of many traditional property/casualty lines. Agents must possess a higher degree of training and expertise than their non-NFIP participating counterparts, which requires updating their continuing education credits through flood conferences and seminars. This is done regularly and often involves traveling to different regions of the country, costing personal time and money. Every agent assumes these responsibilities voluntarily and does so as part of being a professional representative of the NFIP.

#### **Private Market Alternatives and H.R. 4558**

Since the start of the NFIP, private flood insurance has been understood to satisfy requirements and mandates to purchase flood insurance. In 2010 Congress passed the Biggert-Waters “Flood Insurance Reform Act” (FIRM). Included in this legislation was section 100239, which the Big “I” strongly supported because it reaffirmed the intent that private primary flood insurance should satisfy the requirements of mandatory purchase.

Unfortunately, there was a lack of clarity in the legislative language as to what constituted acceptable private flood insurance. Consequently, there has largely been a rejection of private primary flood insurance by lenders who are rightly concerned about the validity of privately issued flood insurance.

In order to provide clarification and eliminate this uncertainty among consumers, agents/brokers and lenders, H.R. 4558, the “Flood Insurance Market Parity and Modernization Act of 2014” by Rep. Dennis Ross (R-Florida) and Patrick Murphy (D-Florida), provides a simple and clear definition of what is acceptable private flood insurance. H.R. 4558 would define acceptable private flood insurance as a policy that provides flood insurance coverage issued by an insurance company that is licensed, admitted or otherwise approved to engage in the business of insurance in the state or jurisdiction in which the insured building is located, by the insurance regulator of the state or jurisdiction.

It is important to note that under the Ross-Murphy proposal, private market policies

would be fully regulated by the State Insurance Commissioners. Private insurers are already subject to statutes and regulations in each and every state. State insurance commissioners are the most appropriate regulators to allow and disallow any policy they deem improper and they have significant ability to assure fair and equitable settlement of claims.

The Big "I" supports the intent of this legislation, as we would strongly support additional options for consumers and more markets for agent/brokers. Furthermore, this legislation is consistent with our strong support for state regulation of insurance.

**Issue with "Continuous Coverage"**

Despite our overall support of the intent of this legislation, the Big "I" does have one particular concern with the language as it is currently written. Under the current rules of the NFIP, if a policyholder were to leave the NFIP for any reason that policyholder would, should they choose in the future to return to the NFIP, likely lose any subsidy and/or grandfathered status that the policyholder had previously had with the NFIP. The NFIP policyholder must maintain "continuous coverage" with the NFIP in order to maintain subsidy and/or grandfather status. The premise behind this makes sense on a public policy basis, as consumers should be encouraged to maintain their policies in order to have financial protection in the event of a flood.

Unfortunately, as currently written this loss of subsidy and/or grandfather would also occur in the case of a policyholder who chose to leave the NFIP and experiment with a private market option. If an NFIP policyholder who either had a subsidy or a grandfathered rate elected to leave the NFIP and got a private market policy, that consumer would lose that subsidy and/or grandfather rate should they be displeased with the private market and decide to return to the NFIP. This loss would be permanent. It should be noted that in some circumstances a grandfathered status could be restored, but it would require extensive paperwork and proof that the structure or building was in compliance with the codes at the time.

The situation regarding what qualifies as "continuous coverage" would strongly disincentive consumers from ever experimenting with a private market alternative. Additionally, the current language would also strongly disincentive agents and brokers from recommending to their clients that they even try a private market alternative. The fear, from an agent and broker perspective, is that a client would try the private market, not be happy with it, attempt to rejoin the NFIP, find out they have lost their subsidy and/or grandfather status forever, and decide their only recourse would be legal action against the agent/broker for not cautioning them of this possibility. In fact, the Florida Association of Insurance Agents (FAIA) has already drafted a disclosure and encourages agents to have clients sign the disclosure to point out the risk they are taking when they move to a private policy.

Finally, it should be pointed out that in all other lines of property/casualty insurance "continuous coverage" does not mean coverage from one particular source.

The solution to this situation is simple, and one that we are asking Reps. Ross and Murphy and the Committee to make as this bill makes its way through the legislative process. We would simply request that, as much as the bill states that a private flood policy approved by a state insurance regulator count as an “acceptable” policy by a lender, that a private flood policy approved by a state insurance regulator also count as “continuous coverage” by the NFIP. The purpose of the Ross-Murphy legislation is to make private flood policies more widely available to consumers across the country, but without fixing the “continuous coverage” language consumers will likely choose the safe route by keeping their NFIP coverage and not even giving the private market a chance.

### **Conclusion**

The Big “I” is pleased to offer the Subcommittee our views on the NFIP and private market alternatives at today’s hearing. We support the intent of the legislation and especially support the goal of providing additional options for consumers and markets for agents and brokers. We’d particularly like to thank Reps. Ross and Murphy for their work on this legislation and look forward to working with them further to address our concern over what constitutes “continuous coverage.” It is our sincere hope that agreement can be reached soon on language, and we thank the Subcommittee for conducting today’s hearing.



Statement  
of  
National Association of Mutual Insurance Companies  
to the  
United States House of Representatives  
Financial Services Subcommittee on Housing and Insurance  
Hearing on  
“Opportunities for a Private and Competitive Flood Insurance  
Marketplace”

November 19, 2014

The National Association of Mutual Insurance Companies is pleased to offer comments to the United States House Financial Services Subcommittee on Housing and Insurance on "Opportunities for a Private and Competitive Flood Insurance Marketplace."

NAMIC believes that there are a number of problems with the NFIP as it is currently structured. Many of those problems were intended to be addressed in reforms passed under the Biggert-Waters Flood Insurance Reform Act of 2012. NAMIC strongly supported some of those provisions, particularly moving towards actuarial risk based rates. NAMIC also supported language that would have allowed for lending institutions to accept private sector policies that would have met the mandatory purchase requirement of the NFIP. NAMIC opposed the delay and repeal of a number of those changes made when Congress passed the Homeowner Flood Insurance Affordability Act of 2014.

We are the largest property/casualty insurance trade association in the country, serving regional and local mutual insurance companies on main streets across America as well as many of the country's largest national insurers. The 1,400 NAMIC member companies serve more than 135 million auto, home and business policyholders and write more than \$196 billion in annual premiums, accounting for 50 percent of the automobile/homeowners market and 31 percent of the business insurance market.

#### **The Nature of Flood Risk**

In order for insurance markets to function properly, certain conditions must be met. For example, individual exposures should be independent of each other (i.e., not correlated) and there should be a large number of individual risk exposures to allow the use of statistical predictions of future losses. Losses should be accidental or unintentional in nature and should be generally predictable, allowing insurers to set premiums properly. Insurers must be able to spread risk over a large enough pool and each insured must pay the cost of adding to the risk pool.

For some risks, however, private insurance markets are unable to provide sufficient coverage. Certain risks are more difficult to insure because they defy the conditions private markets require for operation. Flood risks are one of those. Adverse selection prompts only those who believe they are at risk of flooding to purchase insurance, which limits insurers' ability to properly pool risk. Properly priced insurance (which takes into account the amount of surplus needed to pay claims in high-loss years) would be regarded by most potential purchasers as a "bad buy" – property owners who perceive that there is little likelihood they will experience loss due to flooding will conclude that the cost of purchasing insurance is not worth it. Flooding is extremely devastating and markets face serious problems providing coverage for these truly large and costly events. The fact that flooding involves a risk that is highly concentrated and correlated makes flood loss especially difficult to insure. In most lines of insurance (e.g., life, auto, fire insurance), the total amount in premiums collected and the total amount paid in claims are almost continuously in balance because claim costs for any given year are relatively predictable. This is not the case with flood risk, which by nature tends to result in losses that are very low in some years and extremely high in other years. Additionally, unlike other traditional

threats to property, flooding has historically been spatially confined and generally limited to specific geographic locations, complicating an insurer's ability to widely spread the risk. Compensating for these challenges requires insurers to charge high premiums to cover the sizable cost of capital that they must hold in reserve to ensure they are able to pay all the claims that will be filed in high-loss years.

#### **The National Flood Insurance Program**

Prior to the creation of the NFIP, flood losses were dealt with in a simple and direct fashion by the federal government. As noted in a 2002 report by the Federal Emergency Management Agency, "major riverine flood disasters of the 1920's and 1930's led to considerable Federal involvement in protecting life and property from flooding through the use of structural flood-control projects, such as dams and levees, with the passage of the Flood Control Act of 1936." These projects proved to be a costly and generally ineffective solution. Despite billions spent by the federal government on flood control projects during that time the report noted that "the losses to life and property and the amount of assistance to disaster victims from floods continued to increase." Furthermore, the only assistance available to flood victims at that time was direct federal disaster aid, which also contributed to the high costs of a major flood catastrophe. Congress began considering the potential for a national flood insurance mechanism as early as the 1950s, but quickly realized that the private market simply could not underwrite the highly concentrated and correlated risk of massive floods. In 1968, the federal government stepped in to create the NFIP to mitigate the exposure both to taxpayers as well as citizens in flood-prone areas. Congress sought to address the increasing costs of taxpayer-funded disaster relief by using premium dollars taken in every year to pay out any flood losses incurred by policyholders for the same year.

Originally, the only way property owners could purchase NFIP coverage was through specialized insurance agents. To increase take-up rates and streamline the claim handling process, the NFIP in 1983 created a "public-private" partnership with private insurers known as the Write-Your-Own (WYO) program. The program utilizes private insurers to market, sell, and administer the Standard Flood Insurance Policy. These companies – WYO carriers – use their own agents and letterhead and deal directly with the policyholders while the federal government retains responsibility for underwriting losses. The partnership has proven successful in facilitating the prompt settlement of claims, even when faced with a very large volume of claims following extreme flooding events.

Over the last 40 years, the NFIP has allowed millions of Americans to avoid serious financial losses brought about by disastrous flooding. However, the NFIP has many flaws in its design and execution and is in need of serious reform in order to maintain a sound financial footing and better protect the American taxpayer. Subsidized premiums have been charged on a non-actuarial basis; development has increased the amount and value of property exposed to flood risk; take-up rates for those in need of coverage remain extremely low; and the recent severity of flood losses has demonstrated that the NFIP is not constructed to handle major catastrophic

events. Although virtually self-sustaining for the 25 years prior, in 2005 the program incurred over \$20 billion in debt.

Under the current circumstances, it is not surprising that policymakers are asking the panel today what options there are for the private marketplace to offer flood insurance policies. Clearly the status quo is unacceptable. Nothing about the realities of flood risk has fundamentally changed. Primary insurers are still unable to offer this coverage as the continuance of the NFIP offering subsidized rates prevents companies from offering policies at rates that are simultaneously risk-based and competitive with NFIP subsidized rates. As actuarial risk-based NFIP rates began to be implemented in accordance with the Biggert-Waters Flood Insurance Reform Act of 2012, a few private sector companies began to offer policies. Many WYO Companies also began to research and prepare to potentially offer private sector policies. However, when members of Congress passed the Homeowners Flood Insurance Affordability Act of 2014, which delayed and repealed the movement towards actuarial rates, private sector development halted. That repeal, coupled with potential rate restrictions at the state level, continues to prevent the development of a private marketplace for flood insurance.

#### **Charge Actuarially Sound Rates**

Inadequate rates that do not reflect the actual costs of living in a flood-prone area are the source of many of the NFIP's problems. In the original NFIP legislation, Congress tasked FEMA with setting rates to meet the "objective of making flood insurance available where necessary at reasonable rates so as to encourage prospective insureds to purchase such insurance." The program was structured to subsidize the cost of flood insurance for existing homes, while charging actuarially sound rates for newly constructed properties built after the introduction of flood insurance rate maps. It has been estimated that, on average, the premiums charged for these older properties are 60 percent less than the amount that would be considered actuarially sound.

Moreover, it is doubtful that the rates charged for properties built after the advent of flood maps comport with most private insurers' conception of "actuarially sound." The price for NFIP flood insurance is relatively low—on average nationwide, property owners pay only \$2.64 per \$1,000 of flood coverage, or \$528 per year for \$200,000 in coverage. This average is constant across all states, including highly flood-prone states, which sustained major flood losses during the 2004, 2005, and 2008 hurricane seasons. Insofar as these rates do not reflect the true cost of providing coverage, the NFIP bears less resemblance to insurance than to a taxpayer-financed risk management program that disproportionately benefits a relatively small segment of the U.S. population.

Just as inadequate rates fail to reflect the true cost of providing coverage, they also fail to reflect the actual risks of living in a flood-prone area. This has the effect of encouraging poor land use and development in high-risk areas, thereby increasing the total potential losses that will be incurred in the event of a flood. During the 40-plus years that the NFIP has been in place, there has been a large population increase in flood-prone coastal states, which now account for a very large portion of the NFIP portfolio. In Florida, for example, the population has increased from

6.8 million in 1970 to nearly 18.5 million in 2009. During the same period, there was a seven-fold increase in the number of NFIP flood policies in force and now more than two-thirds of NFIP policies are located in just five coastal states.

The NFIP must begin charging risk-based rates if it is to have any chance of being a solvent program. Moreover, the implementation of risk-based NFIP rates is a prerequisite for private insurers to be able to offer private sector flood policies. The move to actuarially sound rates is likely to be painful due to the higher premiums that will have to be charged in many instances. For those property-owners who need assistance, flood vouchers might be offered on a means-tested basis to help mitigate the costs. Any subsidies that the government believes are necessary must be independent of the NFIP and fully transparent. Subsidies cannot continue to be hidden within the insurance mechanism, and homeowners should be fully aware of the real risks of where they live.

#### **Conclusion**

The NFIP is in need of significant reforms in order to continue providing flood protection to those who need it. As a practical matter, there is no substantial private residential market for flood insurance and efforts to create one will continue to be frustrated by rate regulation, adverse selection, and capital constraints. However, other proposals that seek to explore a risk-bearing role for the private sector in the NFIP may have merit and should be given due consideration. For example, ceding a portion of the NFIP's risk to the private sector through reinsurance and catastrophe bonds could reduce taxpayer exposure to future debt. NAMIC thanks the Committee and we look forward to working with Congress on continued reforms to the NFIP and options for a private marketplace for flood insurance.



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Professional Surplus Lines  
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**Testimony of  
The National Association of Professional Surplus Lines Offices  
Before the  
House Financial Services Subcommittee on Insurance & Housing  
November 19, 2014**

The National Association of Professional Surplus Lines Offices (NAPSLO) is the professional trade association representing the surplus lines industry and the wholesale insurance distribution system. Since its formation in 1974, NAPSLO has become the authoritative voice of the surplus lines industry, advocating for the industry's vital role the insurance marketplace and global economy. The surplus lines market plays an important role in providing insurance for hard-to-place, unique or high capacity (i.e., high limit) risks. Often called the "safety valve" of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by insuring those risks that are declined by the standard underwriting and pricing processes of standard/admitted insurance carriers. With the ability to accommodate a wide variety of risks, the surplus lines market acts as an effective supplement to the admitted market.

Surplus lines insurers are able to cover unique and hard-to-place risks because, as nonadmitted insurers, they are able to react to market changes and accommodate the unique needs of insureds that are unable to obtain coverage from admitted carriers. This results in cost-effective solutions for consumers that are not "one size fits all," but are instead skillfully tailored to meet specific needs for non-standard risks.

NAPSLO's membership consists of approximately 400 brokerage firms, 100 surplus lines insurers and 200 associate firms, all of whom operate over 1,500 offices representing approximately 15,000 to 20,000 individual brokers, insurance company professionals, underwriters and other insurance professionals

[www.napslo.org](http://www.napslo.org)

globally. NAPSLO is unique in that both surplus lines brokers and surplus lines companies are full members of the association; thus NAPSLO represents and speaks for the surplus lines wholesale marketplace. We appreciate the opportunity to submit testimony to today's hearing.

#### **Increasing Private Market Solutions for Flood Insurance**

NAPSLO appreciates the Committee's continued efforts to expand the provision of flood insurance to the private market. To that end, NAPSLO strongly supports H.R. 4558, the *Flood Insurance Market Parity and Modernization Act of 2014*, introduced by Reps. Ross and Murphy. The updates and improvements made by Congress to the National Flood Insurance Program (NFIP) in recent years have demonstrated this body's desire to allow consumers to have the option of securing private flood insurance policies to fulfill their coverage obligations. This critical legislation is necessary to achieve this goal.

Although the recent changes addressing flood insurance intended to increase private market solutions, clarification to the definition of private flood insurance is needed to ensure the surplus lines market can provide solutions to consumers, which had long been accepted as appropriate coverage. Absent a clarification of the definition, we fear lenders may be hesitant to accept private flood insurance policies from surplus lines insurers. H.R. 4558 provides a simple, commonsense change that will fix this concern.

#### **The Regulation of Surplus Lines**

To secure a nonadmitted insurance policy, an insured does not go directly to the nonadmitted market for coverage. In most instances, the risk must first be "declined" after a "diligent search" of the admitted market, which generally means that they must first seek coverage from companies licensed to write the risk in the admitted market. Once it has been determined that the admitted market cannot or will not accept the level of risk, the nonadmitted market may provide the coverage. This is why surplus lines is considered the "safety valve" for insureds unable to find coverage in the admitted market.

The financial and market regulation of a surplus lines insurer, like admitted insurers, is the purview of the surplus lines insurer's domiciliary state. In addition, the regulation and taxation of individual surplus lines transactions is also through the licensed surplus lines broker. Surplus lines brokers work directly with retail agents and brokers representing those insureds who are unable to obtain insurance through

the admitted market. The licensed surplus lines broker is responsible for (1) selecting an eligible surplus lines insurer; (2) reporting the surplus lines transaction to insurance regulators; (3) remitting the premium tax due on the transaction to state tax authorities; and (4) assuring compliance with all the requirements of the surplus lines regulations.

Although the surplus lines market is regulated differently than the admitted market, in order to provide the flexibility necessary to innovate and customize solutions for hard-to-place risks, it is important to understand that it is indeed subject to diligent regulation. Each U.S. based surplus lines company is licensed (admitted) in at least one of the 50 states or other U.S. jurisdictions and must fulfill the solvency and market regulatory requirements of that state or jurisdiction. Like admitted insurers, the surplus lines insurer's state of domicile is the regulator of that insurer's solvency and market practices, and the nonadmitted insurer submits to all the same rigorous rules and regulations as an admitted insurer. Where the markets differ is that nonadmitted policies are not subject to the rate and forms requirements applied to the admitted market, allowing the nonadmitted market the flexibility to innovate and underwrite customized solutions for unique risks in an actuarially sound fashion.

Nonadmitted insurance companies have a tremendous solvency record. In 2014, A.M. Best reported that for the tenth year in a row, the industry reported no financially impaired surplus lines companies. By comparison, there were 14 disclosed impairments by the admitted market during this period. Domestic professional surplus lines insurers continue to maintain a higher proportion of secure ratings than the overall property/casualty industry. Through midyear 2014, 100% of surplus lines companies maintained secure A.M. Best ratings. This exceptionally strong record of solvency speaks to the quality of products and security offered by the nonadmitted industry.

#### **Conclusion**

NAPSLO strongly encourages you to support H.R. 4558, and make clear that the nonadmitted insurance industry is an eligible provider of flood insurance coverages that the National Flood Insurance Program and admitted market either cannot or will not underwrite. This will help ensure consumers have all the options necessary to find private market solutions to flood exposures. NAPSLO would be pleased to

answer any questions that the Committee, its Members or staff may have on this issue or related to the surplus lines industry. Thank you again for the opportunity to comment on this important issue.



Statement for the Record

November 19, 2014

Submitted to the

Subcommittee on Housing and Insurance

The Committee on Financial Services of the

United States House of Representatives by

the

Property and Casualty Insurers Association of America (PCI)

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to submit the following statement regarding the Flood Insurance Market Parity and Modernization Act of 2014 (H.R. 4558) for the record.

PCI supports the Flood Insurance Market Parity and Modernization Act of 2014. PCI's mission is to promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers. PCI's principles of good insurance regulation include the recognition of a wide variety of property-casualty business models to increase private competition.

PCI applauds Rep. Dennis Ross' introduction of the Flood Insurance Market Parity and Modernization Act of 2014. PCI remains dedicated to working with House and Senate leaders to strengthen flood protection and risk management options for the millions of Americans who depend on flood insurance to protect their homes and businesses. This common sense legislation clarifies the intent of Congress that private flood insurance should be an option available to homeowners.

PCI's members include more than two-thirds of the insurers that partner with the NFIP through the "write-your-own" (WYO) program to sell, service and administer this federal program. PCI is comprised of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than \$195 billion in annual premium, 39 percent of the nation's property casualty insurance. Member companies write 46 percent of the U.S. automobile insurance market, 32 percent of the homeowners market, 37 percent of the commercial property and liability market and 41 percent of the private workers compensation market epitomizing the diversity and strength of the U.S. and global insurance markets.

PCI looks forward to the Subcommittee's further consideration of this bill and would be happy to discuss it with you at your convenience.

**RAA**  
REINSURANCE ASSOCIATION OF AMERICA  
1445 New York Avenue, N.W., 7<sup>th</sup> Floor, Washington, D.C. 20005-2134

Telephone: (202) 638-3690  
Facsimile: (202) 638-0936  
<http://www.reinsurance.org>

November 18, 2014

The Honorable Randy Neugebauer  
Chairman House Financial Services

The Honorable Michael Capuano  
Ranking Member House Financial Services Committee

Dear Chairman Neugebauer and Ranking Member Capuano:

On behalf of the members of the Reinsurance Association of America, I am writing to express our support for H.R. 4558, the "Flood Insurance Market Parity and Modernization Act of 2014" legislation introduced by Rep. Dennis Ross (R-FL), and co-sponsored by Rep. Patrick Murphy (D-FL).

H.R. 4558 would give states the authority and flexibility to license and regulate flood insurers, while removing "one size fits all" federal restrictions that inhibit private flood insurance coverage. The legislation would charge the states with the responsibility to regulate private insurers offering flood insurance for mortgage acceptability, much as the states do today with regard to homeowners insurance. States have the regulatory expertise and are in the best position to undertake this role.

The private reinsurance market has an appetite and interest in underwriting flood risk. Rep. Ross' legislation will provide homeowners with more options in terms of pricing and coverage, and additionally, reduce the federal government's role in providing taxpayer subsidized flood insurance through the National Flood Insurance Program.

The RAA looks forward to working with the Committee to advance this legislation in the House of Representatives.

Sincerely,



Franklin W. Nutter  
President

CC: Members of the House Financial Services Committee

The logo for SMARTERSAFER.org is displayed on a dark, textured background. The text "SMARTERSAFER.org" is in a bold, white, sans-serif font. Below it, in a smaller, lighter font, is the tagline "Americans for Smart Natural Catastrophe Policy".

**SMARTERSAFER.org**

Americans for Smart Natural Catastrophe Policy

The Honorable Jeb Hensarling  
Chairman  
House Financial Services Committee  
Washington DC, 20515

Dear Chairman Hensarling:

SmarterSafer-- a broad based coalition of taxpayer advocates, environmental groups, insurance interests, housing organizations, and mitigation advocates-- welcomes the efforts of Reps. Ross and Murphy and Sens. Tester and Heller to ensure that consumers can purchase flood insurance in the private market if they choose. For too many years, the federal government has been the primary provider of flood coverage in the US. The National Flood Insurance Program (NFIP) has provided critical coverage, but as Congress has recognized, because of deep subsidies embedded in the program for a segment of properties, it has done so at great expense to taxpayers, it has harmed the environment, and it has provided the wrong market signals, actually encouraging people to build in harm's way.

To combat these problems, Congress made changes to rates for certain properties, slowly phasing in risk-based rates and allowing private flood coverage in addition to other reforms. Since the passage of flood reform, private insurers have started to more broadly offer flood policies. SmarterSafer believes this should be encouraged; Consumers should be able to choose private flood policies, potentially with terms and coverage that can be tailored to the interests of the consumer, as well as better incentives for mitigation and resiliency.

The Ross-Murphy and Tester- Heller bills would ensure that private flood insurance counts for purposes of the mandatory purchase requirements in flood zones. SmarterSafer supports these efforts and will work to see them passed into law. To make the changes as effective as possible, Congress should provide that if a homeowner opts for uninterrupted coverage through a private policy, the homeowner should not be treated as having a 'lapse' in coverage under NFIP. This would allow a homeowner to return to the NFIP, if they desire, without penalty. In addition, all consumer protections afforded in a state to other types of policies should apply for flood policies to ensure policyholders have recourse if a company goes insolvent or is not meeting their obligations under their policies.

We look forward to working with you on this matter.

Sincerely,

SmarterSafer.org



OFFICE OF INSURANCE REGULATION

KEVIN M. MCCARTY  
COMMISSIONER

FINANCIAL SERVICES  
COMMISSION  
RICK SCOTT  
GOVERNOR  
JEFF ATWATER  
CHIEF FINANCIAL OFFICER  
PAM BONDI  
ATTORNEY GENERAL  
ADAM PUTNAM  
COMMISSIONER OF  
AGRICULTURE

July 11, 2014

The Honorable Dennis A. Ross  
228 Cannon HOB  
Washington, DC 20515

Re: H. R. 4558 – Flood Insurance Market Parity and Modernization Act of 2014

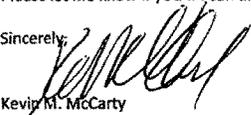
Dear Congressman Ross:

It was a privilege to meet with you recently to discuss a range of important insurance issues, state, federal and international. One of the issues we discussed related to flood insurance and focused on ways to encourage private insurers to write flood insurance.

As you know, current flood insurance law is very prescriptive and defines "private flood insurance" in narrow terms. The law now requires that private flood insurance coverage be at least as broad as that provided by the National Flood Insurance Program, and specifies a number of required policy provisions. While well intended, these provisions could stifle private market competition and discourage the private insurance market from offering flood insurance coverage.

H. R. 4558 co-sponsored by you and Congressman Murphy and entitled the Flood Insurance Market Parity and Modernization Act of 2014, seeks to simplify federal flood insurance law and encourage the development of a robust private flood insurance market. This common-sense legislation strikes the prescriptive policy provisions discussed above and allows insurance commissioners throughout the United States to approve the sale of private flood insurance in accordance with each state's law. I support the provisions of H. R. 4558 and commend you for fashioning straightforward language which will encourage the sale of flood insurance by the private market and offer consumers in Florida and throughout the United States with access to meaningful choices for flood insurance products.

Please let me know if you if I can any questions or if I can assist you in any way.

Sincerely,  
  
Kevin M. McCarty

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KEVIN M. MCCARTY • COMMISSIONER  
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