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INVITED ARTICLE

Two New Developments Hold Promise for the Private Flood Insurance Market

Lisa Miller

> "With ever increasing NFIP rates, it's only natural that a private market should relieve some of NFIP's lower-risk portfolio. With the NFIP in debt to the tune of nearly $21 billion, shifting risk appropriately to the private market is both smart public policy and increases the availability and affordability of flood insurance for consumers."
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> Lisa Miller

Recent news that federal financial regulators have adopted a final rule compelling lenders to accept private flood insurance, together with a renewed effort to adopt a model flood insurance law for all states to encourage a private market, bodes well for consumers and the growing private insurance sector. Not only will these developments create more available and affordable flood insurance options, but they will also shift more risk onto the private market and away from the federal government's debt-burdened, taxpayer-subsidized National Flood Insurance Program (NFIP).

In January, federal financial regulators came to agreement and issued a rule mandating banks and other lenders accept private flood insurance to satisfy coverage requirements. The rule, which becomes effective July 1, should make private flood insurance more available in flood zones, especially in flood-prone states such as Texas, Louisiana, and Florida, where NFIP policies dominate.

Under the rule, lenders will have to accept private flood insurance policies if they offer coverage at least as comprehensive as the NFIP. Lenders will also have an option to accept private flood insurance policies that don't offer as much coverage as the NFIP, which the insurance industry and others have been advocating for several years.

Meanwhile, the National Council of Insurance Legislators (NCOIL) is in serious discussion on model legislation to encourage the development of a private flood insurance market in all 50 states, based on Florida's successful example.

NCOIL has formed a Special Committee on Natural Disaster Recovery with the goal of providing insurance-specific guidance to states across the country in their efforts

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toward preparing for, mitigating, and recovering from a natural disaster. A key part of the committee's work will be bridging the insurance gap, especially flood insurance, where recent events have clearly shown too many homeowners are uninsured, with tragic consequences.

Creating a Private Flood Insurance Market is Critical

A Federal Emergency Management Agency (FEMA) analysis from last year is shocking: 69 percent of American homes in high risk flood zones do not have flood insurance.[1] Another report reveals nearly a quarter of the nation's properties should be listed in high risk zones—but are not.[2] Congress's continued failure to reform an increasingly expensive NFIP, coupled with record-setting floods from 2017's Hurricane Harvey in Texas and last year's Hurricane Florence in the Carolinas, has created an urgent need to improve the availability and affordability of flood insurance. The state legislatures can help address this dangerous situation by encouraging a private flood insurance market.

In most states, there are no private insurance companies writing primary flood insurance, defined as up to $250,000 in coverage. North Carolina has just one private insurer; South Carolina has two. Although 338,203 North and South Carolinians had NFIP coverage when Florence struck, millions of others did not, resulting in tremendous out of pocket expense to rebuild from Florence's wrath. Property damage is estimated at $13 billion but at least half of that is uninsured. When economic losses are added, the total is nearly $24 billion. FEMA's recent report on an affordability framework for the NFIP found that only residents with higher incomes are buying NFIP policies, leaving an ever-growing number of others unprotected.[3] While FEMA studies this, the private market is moving ahead and delivering more affordable flood insurance where it can.

New catastrophe models are allowing insurance companies to better understand and accurately price flood premiums—down to the individual property—creating an entree back into a market that many carriers had steered clear of for decades. The new models are also providing greater consumer choice and alternatives to the NFIP. When state government sends a message to attract private insurance businesses, a vibrant, competitive environment emerges as it has in Florida where, in just 3 years, almost 30 companies are offering better coverage at a cheaper price.[4] In Miami-Dade County, ground zero for Hurricane Andrew in 1992, one private insurer's average premium is $677 compared to the NFIP's $980 average.[5]

Studies by worldwide actuary Milliman reveal that more than 90% of homes in New Jersey and New York and 92% of Texas homes, 77% of Florida homes, and 69% of Louisiana homes could see cheaper premiums with private insurance versus NFIP policies.[6]

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[1] FEMA Press Office (2018a).
[2] CoreLogic (2017).
[3] See Federal Emergency Management Agency (2018b), page 11.
[4] Florida Office of Insurance Regulation (2018).
[5] See rate comparison at http://lisamillerassociates.com/wp-content/uploads/2018/07/July-2018-Private-Flood-Insurance-Rate-Comparison-with-NFIP.pdf.
[6] See Watkins and Rollins (2018) and Watkins (2017).

Drafting a Framework for the Nation

The use of catastrophe models in setting rates isn't new. But as in the case of wind and earthquake insurance, modeling is usually used together with claims data to determine future risks and corresponding rates. Despite repeated requests, the NFIP hasn't made usable flood claims data available to the private market, citing privacy concerns.

Further complicating matters is the lack of consistency among individual state insurance departments on how catastrophe models may be used in submitting rates. Greater consistency and acceptance of the improved data produced from these powerful predictive models is needed to promote a private flood insurance market.

Florida's successful model laws, SB 1094 (2014) and SB 542 (2015), together were game-changers in encouraging a private flood insurance market in the Sunshine State.[7] The NCOIL committee is now considering the re-authorization of, and amendments to, the existing NCOIL State Flood Disaster and Mitigation Relief Model Act.[8] The amendments reflect Florida's concept of "if you build it, they will come." They are based on Florida Statute 627.715, enacted in 2014 that aim to encourage a robust private flood insurance market to provide consumer choices to the NFIP.

Closing the insurance gap in this country is vital to ensuring that states and their residents can properly and efficiently recover from a natural disaster. NCOIL President, Louisiana state Senator Dan "Blade" Morrish, said last month that NCOIL "believes that expanding access to the private flood insurance can be a large step towards closing the gap. The difference between what is insurable and what is currently insured is simply too large."

State legislators from around the nation are participating in these NCOIL discussions. The draft amendments' language provides the following:

- Form approval if the state regulator currently requires such (some do not) to ensure policies meet or exceed available NFIP coverage
- The ability for insurance companies to test rates in the market without prior approval
- Notice of intent from insurance companies to regulators to enter the market
- Consumer education by insurance agents about flood peril and the coverages available
- Regulator certification that the policies are adequate to meet banking regulation mandates in mortgages

Most of the provisions in the draft narrative have the word "may," so the provisions are permissive. It is written in a manner that is not technical, while providing carrier flexibility, and can serve as the framework for states wishing to reduce their reliance on federal flood insurance. Broad general regulatory frameworks tend to take away business uncertainty.

[7] Both bills are available at www.flsenate.gov.
[8] See National Council of Insurance Legislators (2018).

Some in the insurance industry are concerned that this proposed regulation is overreaching or unnecessary. It is nonetheless designed to provide suggestions to regulators and those regulated on how to work together to launch a successful market. What isn't in dispute is private flood coverage's cost savings, improved benefits, and greater consumer choice.

We Still Need the NFIP

To be clear: We don't need to replace the NFIP, we just need to cooperate to ensure more and better coverage options are available to serve as a complement and alternative to NFIP policies. The NFIP is not the ultimate in flood protection and has significant limitations and policy exclusions. For example:

- NFIP policies limit structural damages to $250,000 for a home and $500,000 for a business and limit contents coverage to $100,000 for a home and $500,000 for a business. They do not cover homeowners' living expenses, such as temporary housing, nor cover loss of income suffered by businesses due to a flood.
- NFIP policies cover flooding from hurricanes, rivers, and tidal waters only when two properties in the area or two or more acres are affected.
- NFIP policies pay only actual damage and replacement costs, not the full value of the policy. Also, unlike many homeowners policies, an NFIP policy is not a guaranteed replacement cost policy—it does not pay more than the policy limit.

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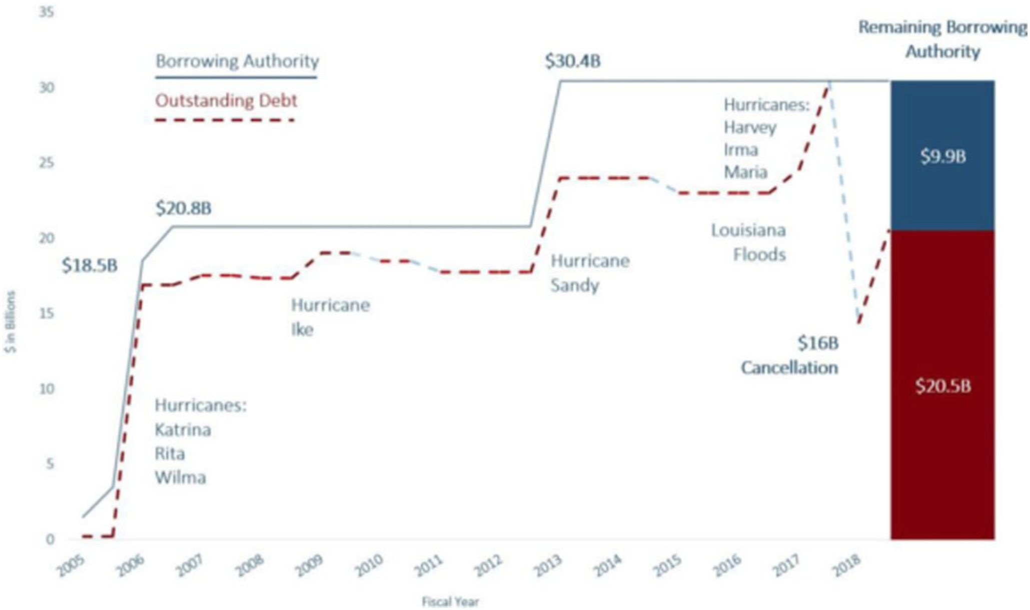
At last summer's National Flood Conference, there was plenty of discussion about NFIP's shortcomings: decades-old maps, some as old as 1970; inconsistency between modeling; a lack of proper flash flooding risk; and that NFIP has violated a key facet of risk management because it's not spreading the risk. The need for greater collaboration and leveraging new technology were common themes.[10]

Figure 1 shows the NFIP's growing debt situation. The NFIP is nearly $21 billion in debt despite a $16 billion bailout from Congress last fall following two years of weather calamities. The program is on its seventh short-term extension (expiring May 31), while Congress considers long-term reauthorization under a package of reform bills called the 21st Century Flood Reform Act (H.R. 2874). The legislation's purpose is to relieve some of the financial burden to the heavily subsidized federal government program, while providing modernization and greater cost accountability and sharing with those properties that continually have losses and keep getting rebuilt or repaired, only to have sometimes identical losses re-occur during the next event.

The U.S. House in late 2017 passed the 21st Century Flood Reform Act, but the Senate has failed to act on it, out of concern by powerful coastal state Senators on the impact of the bill's efforts to encourage a vibrant private flood market.

[9] For more facts about the program, see Miller (2017).
[10] For an excellent review of the limitations inherent in NFIP flood maps, their associated rates to risk, and policy take-up rates, see Kousky (2018).

Figure 1
National Flood Insurance Program—Outstanding Debt [Color figure can be viewed at wileyonlinelibrary.com]



Source: FEMA.

FEMA, meanwhile, is forging ahead on its own and redesigning NFIP's 2019 rates to more realistically price risk, helping reduce another big barrier to private market entry: government subsidized rates. It is also beginning to explore catastrophe models that will eventually replace its older mapping technology, which has been largely based on historical data, such as stream flows and hazard areas based on land use, on which to base risk and rates. FEMA finally loosened its grip and is now allowing WYOs (Write Your Own) insurance companies (those insurance companies that serve as claims and policy administrators for NFIP) to sell private insurance, eliminating a longstanding "noncompete" provision.[11]

FEMA Director Brock Long has publicly committed to make sure that the 50 year-old NFIP and private insurers can work together—each writing the policies they can to reduce the coverage gap. Under the banner of "FEMA Resilience," a new organization within the agency, Long's goal is to double the number of those with flood coverage by 2023 and quadruple mitigation investment in that same time.[12]

Private carriers have and can continue to bring competition and innovation to flood insurance, which is driving lower rates.

[11] See Federal Register (2018).
[12] See Boynton (2018).

We Must Continue the Conversation

NFIP premiums are rising an average of 8% this year but in some areas by 18%—the maximum annual increase allowed under current law. So it just makes sense for state legislatures and regulators to begin the conversation to fast-track the growth of a private market, which also spreads the flood risk to private insurers and away from U.S. taxpayers.

Too many Americans are unprotected from the hazards of flood waters and Hurricane Florence is just the latest example. There's an urgent need to improve the availability and affordability of flood insurance so more homeowners can buy protection for their property and families. Communities that are fully insured rebuild more quickly with greater resiliency, too. While Congressional paralysis stymies needed NFIP reforms, we in the states must work toward model private flood insurance legislation to let Washington know "we got this."

As an advisor on passage of Florida's model laws, I'm pleased that NCOIL leadership is discussing this much-needed model law legislation so that all states can have a viable and reliable alternative and complement to the NFIP. This, together with the news of federal financial regulators compelling lenders to accept private flood insurance, bodes well for consumers.

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