

APPENDIX II – BARRIERS TO THE RESIDENTIAL PRIVATE FLOOD INSURANCE MARKET

Flood Coverage Being “At Least as Broad as” the NFIP

Biggert-Waters specifies that private flood insurance satisfies the mandatory purchase mortgage requirement when a private flood insurance policy affords coverage that is “at least as broad as” the coverage offered by an NFIP flood insurance policy.¹⁸

Many property owners are not required to purchase flood insurance because their home is outside of a Special Flood Hazard Area (SFHA) or because they do not have a federally backed mortgage. Lenders may accept private flood insurance that meets the “discretionary acceptance” definition, which states that lending institutions may accept private flood insurance policies that do not meet the “mandatory acceptance” requirements, provided that certain conditions are met, such as that the policy provides sufficient protection of the loan, consistent with general safety and soundness principles.¹⁹ This distinction may be important for insurers with a product designed with higher-deductible options and/or a shorter cancellation notice for nonpayment of premiums.

Since there was not a federal banking rule in place regarding private flood insurance following the passage of Biggert-Waters, it was challenging to implement the use of private flood insurance for the mandatory purchase mortgage requirement. Some lending institutions thought that they did not have the knowledge necessary to assess whether a flood insurance policy met the definition of private flood insurance set forth in Biggert-Waters.

The federal banking rule became effective July 1, 2019. The rule fulfills the condition in Biggert-Waters that regulated lending institutions accept private flood insurance policies satisfying the conditions specified in the Act. Furthermore, the federal banking rule allows lending institutions to accept an insurer’s written assurances stated in a private flood insurance policy that the appropriate criteria is met. The rule also permits lending institutions to accept some flood insurance coverage plans provided by mutual aid societies.

Theoretically, the federal banking rule removes the acceptance of private flood insurance as a barrier to the private flood insurance market. However, educating the banking industry is clearly still needed as state insurance regulators are still hearing that lenders are telling borrowers that the only flood insurance policy that is acceptable is an NFIP flood policy. Thus, further education regarding the federal banking rule needs to be done. States may want to consider drafting a bulletin that can be used for these purposes.

Continuous Coverage

If an NFIP policy holder lets an NFIP policy lapse, by either not paying premium or going to a private flood insurer, any subsidy the NFIP policy holder would have received is immediately eliminated.²⁰ Legislation currently being considered by Congress to reauthorize the NFIP includes the ability of policyholders to leave the NFIP in order to purchase a private flood insurance policy and then return to the NFIP without penalty.

¹⁸ 42 U.S.C §4012a(b).

¹⁹ Ibid

²⁰ As required by §100205(a)(1)(B) of Biggert-Waters (P.L. 112-141, 126 Stat. 917), only for NFIP policies that lapsed in coverage as a result of the deliberate choice of the policyholder.

Non-Compete Clause

FEMA dropped its non-competes clause in 2018. FEMA now allows Write Your Own (WYO) companies to sell NFIP policies. Therefore, this is no longer a barrier.

NFIP Subsidized Rates

One of the hurdles facing private flood insurance growth involves the NFIP's subsidized rates, as NFIP premiums do not always reflect the full risk of flooding. NFIP rates allow certain policyholders to have more affordable premiums. Additionally, NFIP rates do not incorporate profit, which is an important element for private flood insurers.²¹ Private flood insurers need to charge rates that represent the full risk of the peril.²²

If the NFIP were to reform its rate structure to collect full-risk rates, it might result in the encouragement of more private insurers to write policies in the private flood insurance market. Full-risk NFIP rates would fall closer to what a private insurer would charge. It is important to note that full-risk rates would likely lead to higher rates than those that currently exist.²³

Presently, FEMA is in the process of redesigning its rating system. The new NFIP rating system will be known as Risk Rating 2.0. This new rating structure will add replacement cost value and consider the distance between a property and a source of water. Additionally, Risk Rating 2.0 takes into consideration things that are not reflected in the current rating structure, such as intense rainfall.²⁴ As stated previously it was recently announced that Risk Rating 2.0 will be delayed until Oct. 1, 2021 to allow for more analysis on its impact.

Ability to Assess Flood Risk Accurately

On June 11, 2019, the NFIP released data on flood losses and claims. Prior to the release of this data, insurers viewed the lack of access to NFIP data on flood losses and claims as a barrier for private companies offering flood insurance.

For private flood insurers to manage and diversify their risk exposure, consumer participation to manage and diversify their risk exposure is required. Many private insurers have expressed the view that broader participation in the flood insurance market would be necessary to address adverse selection and maintain a sufficiently large risk pool.²⁵

An established goal of the NFIP is to increase the number of flood insurance policies in force. Even though there is a mandatory purchase requirement for homeowners to purchase flood insurance in certain flood zones, this does not always occur.

As more insurers begin to write private flood insurance, it is likely that consumers will be offered more choices. Private flood insurers may also offer coverages not available through the NFIP. These coverages might include coverage such as basement coverage, business interruption, additional living expenses, etc. Private insurers might also be able to offer higher coverage limits than those offered by the NFIP.

²¹ www.floods.org/ace-files/documentlibrary/committees/Insurance/Emerging_Flood_Insurance_Market_Report-Wharton-07-13-18.pdf.

²² Ibid.

²³ Ibid.

²⁴ Ibid.

²⁵ GAO, Jan. 22, 2014. "Flood Insurance: Strategies for Increasing Private Sector Involvement," 14–127, accessed online at <https://www.gao.gov/products/GAO-14-127>.

Private flood insurance offered as an endorsement to a standard homeowners insurance policy could possibly eliminate instances where it is necessary to differentiate between flood and wind damage.²⁶

²⁶ CRS, May 7, 2019. “Private Flood Insurance and the National Flood Insurance Program,” accessed online at https://www.everycrsreport.com/files/20190507_R45242_968aced5ccda33b36e57f26022e80552ffa6f32d.pdf.