

Testimony of
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Before the
Subcommittee on Housing and Insurance
Committee on Financial Services
United States House of Representatives

Regarding:
How to Create a More Robust and Private Flood Insurance
Marketplace

January 13, 2016

Introduction

Chairman Luetkemeyer, Ranking Member Cleaver, and members of the Subcommittee, thank you for the invitation to testify today. My name is Teresa Miller. I serve as the Commissioner of the Insurance Department for the Commonwealth of Pennsylvania and I am here on behalf of the National Association of Insurance Commissioners (NAIC).¹ I also serve as the Chair of the NAIC's Property and Casualty (C) Committee. On behalf of my fellow state insurance regulators, I appreciate the opportunity to offer our views and perspective on the Flood Insurance Market Parity and Modernization Act (H.R. 2901) and related issues surrounding the development of a private flood insurance market.

Floods are the most common natural disaster in the United States and all 50 states have experienced floods or flash floods in the past five years.² State insurance regulators are keenly aware of the devastating effects floods have on constituents in our states and believe it is critical that flood insurance is available and affordable to protect homes, businesses, and personal property, providing peace of mind. Insurance consumers should have access to multiple options in order to find their preferred coverage and price, and facilitating increased private sector involvement in the sale of flood insurance will help promote these consumer choices and spur competition.

The NAIC supports the Flood Insurance Market Parity and Modernization Act (H.R. 2901) as introduced, and commends Congressmen Ross and Murphy for developing this legislation to help encourage greater growth in the private flood insurance market, provide consumers with additional choices for flood insurance products, and make clear that the state insurance regulatory authorities that have long protected policyholders and allowed for the growth of other vibrant insurance markets will apply to private flood insurance.

Private Flood Insurance Market

In 1968, Congress established the National Flood Insurance Program (NFIP) in response to the lack of availability of private insurance and continued increases in federal disaster assistance due to floods. At the time, flooding was viewed as an uninsurable risk and coverage was virtually unavailable from private insurance markets, particularly in the wake of frequent widespread flooding along the Mississippi River in the early 1960s. In recent years, more sophisticated risk mapping and modeling have developed, enabling the private market to more accurately price the risk and generating new interest among private insurers to provide such coverage. Access to NFIP policy and claims data would also help private insurers assess flood risks and may stimulate the market even more.

While there is limited interest from the admitted insurance market at this time, there is a growing appetite in the surplus lines market to provide private flood insurance coverage. Like many types of new coverages, private flood coverage is being developed and offered first by surplus lines

¹ The NAIC is the United States standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, we establish standards and best practices, conduct peer review, and coordinate our regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

² https://www.floodsmart.gov/floodsmart/pages/flood_facts.jsp

insurers, which typically insure unique or otherwise difficult to underwrite risks that the admitted market is, at least initially, reluctant to insure. Typically, after a new coverage has proven itself profitable in the surplus lines market and sufficient data has been gathered to provide a sound basis for rate development, the coverage tends to become a standard product in the admitted market. Ideally, private flood coverage will follow this path and admitted carriers will eventually engage in this market.

Facilitating the entry of additional carriers into the market will provide consumers with access to additional options for flood insurance products. In Pennsylvania, competition is proving to be good for consumers, providing more choices and better prices. At least five surplus lines carriers sold flood insurance to homeowners in Pennsylvania in 2015, and have written nearly 1,000 policies. We have also started seeing licensed insurers write the coverage, but they currently serve very limited markets.

We are finding in many cases that private carriers are willing to offer comparable coverage at substantially lower cost than the NFIP. In Pennsylvania, one property owner would have paid a \$7,500 annual premium with the federal program, but found private coverage for \$1,415. Another homeowner was quoted a \$6,000 annual premium by NFIP, but found a surplus lines policy for \$900. Yet another homeowner's story is similar to many in Pennsylvania. This individual lived in his home for many years without experiencing a flood, and without flood insurance, but recently was told his property was now in a flood plain because of re-mapping by the Federal Emergency Management Agency (FEMA). NFIP coverage would have cost him \$3,000 a year. He is paying \$1,000 a year for a surplus lines policy.

These are just a few examples. Flood insurance is a big issue in Pennsylvania. FEMA statistics show from 2006 through 2014, Pennsylvania property owners filed more than 18,000 claims with the NFIP, for more than \$551 million in damages, with claims coming from 66 of the state's 67 counties.

Governor Tom Wolf has made consumer protection the top priority for the Insurance Department. I wholeheartedly endorse this legislation, and believe encouraging more private insurers to enter the flood insurance market will provide homeowners needed coverage, often at greatly reduced costs. Over time, this additional competition and shift of risk from a federal program to the private market could help lessen the exposure of U.S. taxpayers to the types of catastrophic flood losses that now reside as unpaid debt on the NFIP's books.

Regulation of Surplus Lines Market

In the case of private flood policies written by surplus lines carriers, state insurance regulators will continue to oversee the surplus lines insurance marketplace by imposing capital and surplus requirements on eligible U.S.-based carriers and licensing and supervising surplus lines brokers. Surplus lines insurers that are domiciled in a U.S. state are regulated by their state of domicile for financial solvency and market conduct. Surplus lines insurers domiciled outside the U.S. may apply for inclusion in the NAIC's Quarterly Listing of Alien Insurers. The carriers listed on the NAIC Quarterly Listing of Alien Insurers are subject to capital and surplus requirements, a requirement to maintain U.S. trust accounts, and character, trustworthiness and integrity requirements.

In addition, the insurance regulator of the state where the policyholder resides (the home state of the insured) has authority over the placement of the insurance by a surplus lines broker and enforces the requirements relating to the eligibility of the surplus lines carrier to write policies in that state. The insurance regulator can potentially sanction the surplus lines broker, revoke their license, and hold them liable for the full amount of the policy.

In Pennsylvania, the Insurance Department can declare a surplus lines insurer ineligible to do business in the state, if the regulator finds the insurer is in unsound financial condition, has willfully violated the laws of the state, or does not make reasonably prompt payment of claims in Pennsylvania or elsewhere. The Insurance Department may also suspend, revoke, or refuse to renew the license of a surplus lines broker for various reasons, including failure to make and file required reports, failure to collect or transmit required tax on surplus lines premiums, failure to remit premiums due insurers or return premiums due insureds within reasonable time limits, or for any other cause for which action can be taken against an insurance producer's license. In Pennsylvania, the Insurance Department also has authority to assess a civil penalty up to \$2,000 for the first offense, and up to \$4,000 for each succeeding offense against anyone violating the Commonwealth's insurance laws.³

Like any other insurance market, as the private flood insurance market grows and more companies offer coverage including admitted carriers, we anticipate the regulation will continue to evolve to meet the size and breadth of the market as well as the needs of insurance consumers. State insurance regulators have a long history of carefully monitoring the emergence and innovation of new products and coverages, and tailoring regulation over time to ensure consumers are appropriately protected.

Flood Insurance Market Parity and Modernization Act (H.R. 2901)

In order to help further facilitate the development of the private flood market, changes must be made to address some of the unintended consequences resulting from the Biggert-Waters Flood Insurance Reform Act of 2012. Although one of its objectives was to provide opportunities for the growth of the private market as an alternative to the NFIP, the definition of and regulatory environment surrounding private flood insurance created by the Biggert-Waters Act is at odds with this objective and makes it more difficult for insurance regulators to protect consumers and ensure availability of the product.

Critical Regulatory Clarifications

The Biggert-Waters Act empowered federal banking and housing regulators and the government-sponsored enterprises (GSEs) to apply their own requirements related to the financial solvency, strength, or claims-paying ability of private insurance companies from which they will accept private flood insurance. This is highly problematic as banking and housing regulators neither have the expertise nor the experience to regulate insurance companies or insurance markets. This also results in duplicative and potentially inconsistent regulatory requirements for insurers and serves as a disincentive for private insurers to consider writing flood insurance coverage.

We understand that it may be appropriate for lending entities and the GSEs to review the financial health of insurers and provide guidelines as to the type of companies its customers may

³ 40 P.S. §§ 991.1603, 991.1623, 991. 991.1607. 991.1625.

purchase from. However, states have over 140 years of experience supervising the business of insurance, protecting policyholders, and balancing availability with solvency. Banking and housing regulators, whose regulatory objectives (i.e., ensuring the safety and soundness of banks and the GSEs) are fundamentally different than insurance consumer protection and promoting competitive insurance markets, are ill suited to regulate insurance. It is inappropriate for them to be given the authority to substitute their judgement for those charged under law with regulating insurance products and protecting policyholders. In fact, the federal banking regulators acknowledged in their proposed rulemaking on private flood insurance that state insurance regulators, as the primary functional regulators of the sector, may be in the best position to evaluate the condition and ability of a private insurer to offer a flood insurance policy.⁴ Moreover, members of this committee have repeatedly affirmed that insurance and its regulation is unique and fundamentally different than banking and other types of financial products.

To address this, H.R. 2901 includes important language clarifying that state insurance regulators have the same authority and discretion to regulate private flood insurance as they have to regulate other similar insurance products and markets. We appreciate these essential clarifications that are critical for state insurance regulators' support for the legislation. Any proposal to amend H.R. 2901 by supplanting state insurance regulators' experience and expertise with those of banking and housing regulators will raise serious concerns for state insurance regulators.

Private Flood Definition

Another impediment for entrants into the private flood market is the definition of private flood insurance included in the Biggert-Waters Act. Private flood insurance is defined in unnecessarily narrow terms with a number of prescriptive conditions. In order for a private market to evolve, we expect insurers would need flexibility to tailor insurance products to meet consumer needs. The Biggert-Waters Act does not allow for this innovation, rather it focuses on ensuring policies do not deviate from its rigid criteria, despite the fact private insurers may be able to offer the consumer additional coverage features or greater limits. H.R. 2901 alleviates these concerns by defining private flood insurance as a policy that is issued by a licensed insurer or eligible surplus lines insurer and provides coverage that is compliant with state laws and regulations. These essential clarifications will assist in removing the restrictive and confusing language in current law to help prompt more insurers to enter this market if they are willing.

Conclusion

As insurance markets evolve, state insurance regulators remain extensively engaged with all relevant stakeholders to promote an optimal regulatory framework—private flood insurance is no exception. As the private flood market develops, we remain committed to effective regulation and to making changes to our regulatory structure when necessary. State insurance regulators will meet any new challenges posed by a dynamic private flood insurance market and we continue to believe that well-regulated markets make for well-protected policyholders. The NAIC appreciates Congressmen Ross and Murphy's leadership in introducing H.R. 2901 and their efforts to encourage greater growth in the private flood insurance market. We thank them

⁴ Loans in Areas Having Special Flood Hazards, 78 Fed. Reg. 65,108 (Proposed Oct. 30, 2013).

for their support of state regulation and look forward to continuing to work with the members of this committee as the bill moves forward. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.