



December 29, 2010

Federal Emergency Management Agency
U.S. Department of Homeland Security
Office of Chief Counsel
500 C Street, SW
Suite 840
Washington, DC 20472-3100

Re: Docket No. FEMA-2010-0065
Public Meetings of National Flood Insurance Program (NFIP) Reform Effort

Dear Sir/Madam:

The National Association of Mutual Insurance Companies (NAMIC) is pleased that the Federal Emergency Management Agency (FEMA) is seeking a top-to-bottom review of the efforts to reform the National Flood Insurance Program (NFIP). On behalf of our members, NAMIC is submitting comments as a part of that process.

NAMIC is the largest and most diverse national property/casualty insurance trade association in the United States. Its 1,400 member companies write all lines of property/casualty insurance business and include small, single-state, regional, and national carriers accounting for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. NAMIC has been advocating for a strong and vibrant insurance industry since its inception in 1895.

As our member companies and their policyholders are key stakeholders in the debate over the future of the NFIP, NAMIC appreciates the opportunity to comment on what we consider to be the best and most effective solutions to the challenges that the program faces.

Background

Congress created the NFIP in 1968 to address the increasing costs of taxpayer-funded disaster relief for flood victims and the increasing amount of damage caused by floods. Recognizing that the private market simply could not underwrite the highly concentrated and costly risk of massive floods, the federal government stepped in to create a program to provide financial protection both to taxpayers as well as citizens in flood-prone areas. The program is designed to use the premium dollars taken in every year to pay out any flood losses incurred by policyholders. While the Standard Flood Insurance Policy

offered by the NFIP is sold and administered by private insurers – “Write Your Own” (WYO) carriers – the federal government retains responsibility for underwriting losses.

Over the last 40 years, the program has been instrumental in alleviating the pain of serious financial losses brought about by flooding for millions of Americans. However, the program has not been without its challenges. Subsidized premiums have been charged on a non-actuarial basis; development has increased the number of people and property exposed to flood risk; take-up rates for those in need of coverage remains extremely low; and the recent severity of flood losses has demonstrated that the NFIP is not constructed to handle major catastrophic events. The program is approximately \$20 billion in debt.

Reform, Don’t Replace the NFIP

To address the concerns with the NFIP, FEMA has launched a multi-step, comprehensive analysis of the program. In the latest phase, FEMA is considering a variety of different directions reform could go: from maintaining the status quo to abandoning the program altogether. **We believe that the best, most effective and viable option is maintaining the current NFIP framework while implementing reforms that address existing weaknesses.**

The presence of a federal program is just as important today as it was 40 years ago. The driving force behind the creation of the NFIP – no viable private market – remains the fundamental issue.

Privatization

Flood is a unique risk. Perhaps most importantly, it is a risk that is enormously difficult to underwrite due to adverse selection. Simply put, only those people that are at risk for flooding will purchase flood insurance, making it virtually impossible to pool risk among a large enough population for a viable and affordable insurance product. In order to underwrite a risk like this, an insurer would need to charge very high premiums and maintain significant capital reserves in case of massive flooding, when all of their policyholders would be making claims. In actuality, the only people who would be able to afford coverage would likely be those that did not need it.

The question has been asked as to whether the private insurance market is ready to handle flood risk now, but nothing about the situation has fundamentally changed and primary insurers are still unable to offer this coverage. Technically, the market is already “privatized” in that there is nothing preventing companies from currently writing flood coverage and competing with the NFIP. Almost none have elected to do so.

Price controls further diminish the opportunity for a private market for flood insurance to develop. In order to achieve a fully privatized market, companies would need to be able

to charge actuarially sound, risk-based rates. However, there are two main problems with this approach. First, lawmakers and/or regulators often impose restrictions that allow high-risk property owners to pay artificially low insurance premiums, forcing lower-risk property owners to subsidize the insurance costs or creating hidden cross-subsidization. Secondly, even if rating freedom was achievable the premiums would likely be much more expensive, making affordability a major issue.

Another suggestion for solving the adverse selection problem is the mandatory purchase requirement. In other words, flood coverage would be included as a required part of every homeowner's policy. Under this proposal, the government would be mandating that citizens purchase a product that most do not need - thereby creating a massive new cross-subsidization. This situation would benefit those who choose to live in flood-prone areas at the expense of individuals who do not. It would also do much to mask the true risks of living in certain areas and incentivize overdevelopment of environmentally sensitive coastal areas and poor land use behaviors.

The questions of how the mandatory purchase requirement or the granting of rating freedom would affect the regulation of insurance are significant. Efforts to reform the NFIP should steer clear of the political debate over state versus federal regulation so as not to hinder the prospects for meaningful reform.

Optimization

NAMIC believes that the NFIP fulfills an important role for protecting citizens from financial losses due to flood. The existing structure provides a strong foundation on which to build the program into one that maximizes this role, is viable, and is financially sustainable.

We recommend a package of key reforms that should include the following:

- **Long-term Reauthorization** – Repeated short-term reauthorization creates uncertainty and can lead to lapses in the program as we saw in 2010. During these lapses, companies were not permitted to write new policies, issue increased coverage on existing policies, or issue renewal policies. The NFIP should be reauthorized for an extended time period in order to give more stability to the program and consumers.
- **Actuarially Sound Rates** – The separation of rates from the actual costs of living in a flood-prone area represents the biggest problem with the program today. In order to avoid incentivizing citizens to move to risk-prone or environmentally fragile areas, the actual price that is charged for flood coverage must reflect the actual risk. The rates charged for flood coverage should be actuarially sound in order to get the program on solid footing.
- **Outside Subsidies** – As noted above, the move to actuarially sound rates is likely to be painful due to the higher premiums that will be charged. For those citizens that

require it, flood vouchers might be offered – independent of the NFIP – to help mitigate the costs. Any further subsidies that the government determines are necessary must be independent and transparent.

- **Updated Flood Zone Maps** – Additional federal funds should be allocated to the national flood hazard mapping program. Updating and improving flood maps should be a priority within FEMA to identify communities that will benefit most from updated flood maps. Speedy adoption of updated flood maps should be encouraged so that people in flood-prone areas can get the protection they need.
- **Improve Take-Up Rates** – Currently only 20 percent to 30 percent of property owners exposed to flood hazards actually purchase insurance. The program needs to improve these numbers dramatically in order to stay on a stable fiscal footing. There are several possible ways to improve these take-up rates:
 - **Stiffer Penalties** – Fines should be imposed on financial institutions that fail to require flood insurance coverage for mortgages on properties in flood-prone areas or allow those policies to lapse.
 - **Improved Education** – The NFIP should be given additional resources and a renewed mandate to improve and expand its public education programs to ensure that more people are made aware of the program and the benefits of having flood insurance coverage to protect their properties.
 - **Disaster Relief Waiver** – Require homeowners in flood-prone areas to sign a waiver stipulating that they forfeit their right to disaster relief in the event they choose not to purchase flood insurance.
- **Debt Forgiveness** – The NFIP is nearly \$20 billion dollars in debt. In order to retain long-term solvency the debt must be forgiven. Currently, the NFIP pays approximately \$900 million a year to the Treasury in the form of interest payments. Without eliminating the debt, the future of the program is in jeopardy.

Conclusion

The FEMA process for reevaluating the NFIP has been a productive one. Considering community-based or free market solutions is a goal that NAMIC shares. However, in this particular case, what may sound good on a conceptual level may create more problems than solutions.

The NFIP is in need of significant reforms in order to continue providing flood protection to those that need it. NAMIC urges FEMA to adopt the suggestions outlined above to maintain and optimize the current structure. NAMIC believes that optimization is the best way to balance all the goals of the reform effort: fiscal soundness, affordability of insurance, adequate coverage for those at risk, floodplain management with reduction of

flood hazard vulnerability, economic development, individual freedoms, and environmental concerns.

NAMIC looks forward to working with the NFIP Reform Working Group and FEMA on this very important issue.

Sincerely,

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