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Statement

of

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Hearing on

Implementation of the Biggert-Waters Flood Insurance Act of 2012:

Protecting Taxpayers and Homeowners

November 19, 2013

Introduction

The National Association of Mutual Insurance Companies is pleased to offer testimony to the Housing and Insurance Subcommittee for the hearing entitled "Implementation of the Biggert-Waters Flood Insurance Reform Act of 2012: Protecting Taxpayers and Homeowners."

NAMIC is 1,400 property/casualty insurance companies serving more than 135 million auto, home and business policyholders, with more than $196 billion in premiums accounting for 50 percent of the automobile/homeowners market and 31 percent of the business insurance market.

NAMIC is the largest property/casualty insurance trade association in the country, with regional and local mutual insurance companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home.

Through our advocacy programs we promote public policy solutions that benefit NAMIC companies and the consumers we serve. Our educational programs enable us to become better leaders in our companies and the insurance industry for the benefit of our policyholders.

When the Biggert-Waters Flood Insurance Reform Act (BW-12) was passed by Congress in July 2012, the National Flood Insurance Program was more than $17 billion in debt to the U.S. Treasury, with virtually no chance that the debt would ever be repaid. The crowning achievement of BW-12 was a set of provisions that aimed to repair and stabilize the program's financial condition, mainly by phasing out many of the premium subsidies that have historically been applied to the riskiest 20 percent of structures in the NFIP's policy portfolio. According to the Government Accountability Office, approximately 1.1 million of the 5.5 million NFIP policies in force in 2012 had subsidized rates. The subsidies are substantial, allowing their beneficiaries to pay 40 to 45 percent less than the risk-based rate while masking the true cost of living in a flood prone area. BW-12 reflected Congress' understanding that this state of affairs could not continue without exposing taxpayers to continually escalating losses.

By the time the first wave of subsidy phase-outs began to take effect this fall, the NFIP's debt had ballooned to more than $25 billion primarily because, as in the past, the premiums collected from flood insurance policyholders were insufficient to pay claims. The continuing deterioration of the NFIP's financial condition would seem to underscore the magnitude of the problem that BW-12 sought to address. Yet now some legislators are wavering on their commitment to risk-based pricing for flood insurance because of concerns that some of their constituents will not be able to afford coverage.

The affordability concerns are understandable, given that the 1.1 million structures whose rates are subsidized would require substantial rate increases to reflect the true cost of insuring the risk they present. According to the GAO, BW-12 immediately began the phase out of subsidies for 438,000 policyholders with another 715,000 discounted policies moving towards actuarial rates over time. Among the structures already facing the phasing out of subsidies, 345,000 are non-primary residences (i.e., vacation homes), 87,000 are businesses, and 9,000 are single-loss repetitive properties.

In response to fears about sudden and dramatic rate increases, mostly stemming from homes sold post BW-12 enactment that immediately face full actuarial rates, some lawmakers have proposed that all rate increases be delayed by four years, which is the entire length of the BW-12 NFIP reauthorization period. Such a "delay" would essentially eviscerate the move toward risk-based rates, with the result that the flood program will continue to be funded by ever-larger taxpayer bailouts. Moreover, delaying the move toward risk-based rates will further incentivize American homebuyers and business owners to continue migrating to risky coastal regions, thanks to the availability of inexpensive flood insurance whose rates disguise the risk that comes with living and doing business on the flood-prone coasts.

Indeed, coastal states such as Florida are facing a future in which flooding is likely to become more frequent and severe due to changes in climate. The *New York Times*[1] recently reported that "Florida is the most vulnerable state in the country to the rise in sea levels" that are expected to occur over the next several decades. The amount of real estate value, and the number of properties potentially affected, rises incrementally with each inch of sea-level rise, the *Times* notes. Interestingly, the article paraphrases one analyst as saying "the most salient indicator of the crisis will be the insurance industry's refusal to handle risk in coastal areas here and around the country that are deemed too exposed to rising seas." The program will be particularly hard hit by sea-level rise in Florida, since the state accounts for roughly 40 percent of all NFIP policies.

Rather than instituting an across-the-board delay in the implementation of risk-based flood insurance rates, Congress should consider other ways to address the problems of affordability caused by the onset of sudden, substantial rate increases:

Provide means-tested assistance to property owners for whom risk-based rates would create genuine hardship.

According to the GAO, nearly 80 percent of subsidized properties are located in counties that rank in the top 30 percent nationwide with respect to average home value. Fewer than 1 percent are located in the 30 percent of counties with the lowest average home values. Unless Congress intends for taxpayer-subsidized flood insurance to become a permanent middle-class entitlement, not all subsidized property owners should continue to enjoy discounted flood insurance rates. An across-the-board four year delay for BW-12 will continue flood insurance subsidies for homeowners who not only can afford incremental rises in their premiums but also should fully realize the risks they face.

Instead, lawmakers should take a more targeted approach to easing the pain for those who truly cannot afford it. One way would be to create a flood insurance voucher program that targets the minority of subsidized property owners for whom risk-based rates would be truly unaffordable. Such a program could be modeled on the Section 8 Housing Choice Voucher program currently administered by the Department of Housing and Urban Development. Under this program, local public housing agencies collect information and data to assess need and determine voucher amounts. This same data could be used to determine eligibility and voucher amounts that would

[1] "South Florida Faces Ominous Prospects from Rising Waters", Nick Madigan, New York Times, Nov. 10, 2013

be made available to property owners who could not otherwise afford their flood insurance premium. Importantly, the voucher amount should not be "baked into" the flood premium; rather, it should be designed so that each voucher recipient sees the risk-based rate to which the voucher amount is applied, thus enabling the voucher recipients to be fully aware of the actual flood risk that he or she faces.

Provide low-interest loans or grants to finance property owners' investment in mitigation.

Mitigation measures, such as elevating structures, have been proven to protect properties from damage caused by flooding. Here again, some property owners will lack the financial resources to pay for such measures. Thus, Congress should consider creating a program that would make financing available to property owners for whom investing in mitigation would be truly unaffordable. Such a program could operate in concert with the voucher program described above. Mitigation tools are a much better method of assisting homeowners who live in flood prone areas. Not only does every $1 spent on mitigation save $4 in the long run, but forces homeowners to confront reality in understanding the risks they face.

Encourage property owners to consider a high -deductible flood policy, and consider allowing property-owners to establish tax-exempt flood loss accounts to pay out-of-pocket flood costs.

The NFIP offers flood insurance purchasers a choice of six deductibles: $500, $1,000, $2,000, $3,000, $4,000, and $5,000. Evidence suggests that the overwhelming majority of policyholders choose the lowest possible deductible. A 2009 study by the Wharton Risk Management Center at the University of Pennsylvania examined NFIP policies in force for Florida properties in 2005 and found that 98.3 percent of policyholders chose a deductible lower than the maximum available one. Moreover, more than 80 percent chose the lowest deductible, and roughly 18 percent chose the second-lowest deductible. The Wharton researchers hypothesized that policyholders who purchased the maximum $250,000 coverage limit would tend to choose a higher deductible because presumably someone living in home worth at least $250,000 could easily afford higher out-of-pocket loss costs, especially for a policy designed to insure against a relatively low-probability event such as flooding. But to the researchers' surprise, this proved not to be the case: nearly 81 percent of policyholders with the maximum coverage limit chose the lowest possible deductible.

As noted, the Wharton study included data from Florida only, but given that the "Sunshine State" makes up 40 percent of the NFIP portfolio, Florida probably serves as a reasonably accurate proxy for the rest of the country with regard to policyholders' choice of deductible. The Wharton findings raise several important questions that directly relate to the flood insurance affordability issue: Are flood insurance buyers unaware of the choice of deductibles available to them? Do they not know that when purchasing flood insurance, no less than with other forms of insurance, choosing a higher deductible results in lower premiums? When lawmakers hear complaints from constituents about exorbitant flood insurance premiums, do they ask the constituent what the amount of their deductible is? Most importantly, how much could NFIP policyholders, particularly those facing subsidy eliminations, reduce their premiums by switching to a higher deductible?

It may turn out that at least some of the flood insurance affordability problem is attributable to something as simple as the policyholder's choice of deductible. If so, it would make sense for policymakers to consider measures that would make risk-based premiums more affordable by encouraging policyholders to choose a higher deductible. Such measures might include "nudging" policyholders into a higher deductible by making a $2,000 or $3,000 deductible the "default" choice. In response to concerns that some property owners may not be able to afford the higher out-of-pocket loss costs associated with high-deductible policies, Congress may wish to consider borrowing a concept from the world of health insurance that has proved popular: combining high-deductible insurance coverage with tax-exempt savings accounts that can be used to pay for losses below the deductible amount.

In sum, if most NFIP policyholders are retaining only $500 in flood risk, perhaps Congress should ask them to retain somewhat more of the risk so that less risk will be transferred to taxpayers.

Conclusion

The NFIP was in need of significant reforms in order to continue providing flood protection to those who need it. NAMIC supports the Biggert-Waters Flood Insurance Reform Act of 2012 as an effective way to balance the many goals of the reform: fiscal soundness, adequate coverage for those at risk, floodplain management (reduction of flood hazard vulnerability), economic development, individual freedom, and environmental protection. Modifications could be made that would assist those who truly cannot afford higher flood insurance premiums, but attention should also be paid to better mitigation techniques which could decrease costs to policyholders and taxpayers.