



Consumer Federation of America

1620 I Street, N.W., Suite 200 * Washington, DC 20006

April 26, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
House Financial Services Committee
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

RE: URGE OPPOSITION TO MULTIPLE PERIL INSURANCE ACT

The Consumer Federation of America urges you to oppose the Multiple Peril Insurance Act (H.R. 1264) when it is marked up this week. This bill would significantly expand the National Flood Insurance Program (NFIP) to require it to make coverage for both flood and wind losses available to homeowners at non-subsidized rates. The legislation is, unfortunately, the wrong solution to the very significant problems that homeowners in coastal areas have had in recent years in obtaining and keeping wind coverage and settling wind claims.

H.R. 1264 would vest the monumental task of developing and administering a system of multi-peril home insurance with a government program that is wholly mismanaged and is already subsidizing unwise construction in flood plains despite instructions from Congress to make the program actuarially sound. There is currently no plan in place to reduce possible wind damage on homes that the government would insure. This means that, despite requirements in the bill that attempt to assure proper land use planning, further subsidization of unwise construction is likely. Moreover, requiring one of the most incompetent federal agencies in recent history -- the Federal Emergency Management Agency (FEMA) -- to supervise the adjustment of both flood and wind claims — would be a recipe for disaster for many homeowners and taxpayers.

Instead of expanding the NFIP to cover wind peril, CFA urges you to refer to the many recommendations we have made to Congress and state lawmakers to ensure that wind coverage is widely available in coastal areas at affordable rates, that wind claims are fairly adjudicated and that homeowners do not have to pay unnecessary expenses or face unreasonable delays in order to receive payment on a wind claim. These measures include:

- Congress should prohibit private write-your-own (WYO) insurers that offer flood insurance from using anti-concurrent causation (ACC) clauses in wind coverage. ACC clauses negate wind coverage for homeowners if flood damage occurs during the same general period of time. The use of ACC clauses is a serious conflict-of-interest for insurers, encouraging them to unjustifiably refuse to pay legitimate wind claims and to

shift the cost for these claims to the NFIP. If insurers were prohibited from using ACC clauses, they would have to fully adjust each wind loss to determine how much of the damage was caused by wind and pay for that damage, subject to audit by the federal government.

- Congress should also require WYO companies to pay policyholders for all legitimate wind and flood losses, and to submit a bill to FEMA to be reimbursed immediately for flood payments, subject to later audit and adjustment.
- States should exercise much greater oversight of the wind insurance marketplace, by prohibiting private insurers from unjustifiably pulling out of coastal areas or raising rates in these regions and requiring them to use fair claims practices. Congress should encourage states to use anti-cherry picking measures to assure that insurers who write home insurance in the nation as part of an overall portfolio of coverage take their fair share of risks in high-risk areas as well. The financial capacity of the property-casualty industry to handle such coverage is high, with retained earnings (surplus) in 2009 of \$511.5 billion, only 2 percent below its strongest showing in history. This surplus figure produces a leverage ratio of earned premium to surplus of 0.8, which is incredibly low and demonstrates the amazing financial strength in the property/casualty insurance industry during an economically troubled period.
- Congress should authorize states to come together, through an interstate compact, to create multi-state insurance pools to reinsure wind losses. This would allow states to follow Florida's lead in replacing private reinsurance with a state backed reinsurance plan that charges full actuarial rates, with savings passed on to citizens of these states.
- Congress should also encourage states to follow Florida's example in setting up state-supported insurance pools that are fully competitive with the private market and that cover property in low, as well as high, risk zones. This prevents the highest risks from being socialized (covered only by state pools) and the lowest risks privatized (covered by private insurers.) If state pools are to provide coverage because of market failures in the private sector, they need to spread their risks just as private insurers do.

Congress Should Not Expand the National Flood Insurance Program to Include Wind Coverage If It is Near Collapse

Calling for NFIP involvement in wind insurance is simply not a good idea, given the significant problems that the NFIP is currently experiencing. The NFIP was brilliantly conceived. Taxpayers would subsidize existing construction but new construction would not be allowed to occur in the highest-risk areas, such as high velocity "V" zones. In lower risk areas that would still experience serious wind damage and flooding, all new construction would have to be elevated according to local building codes.

However, poor management by FEMA and lax enforcement of building requirements by local governments has made the program insolvent. Flood maps that FEMA was originally supposed to update every three years are antiquated. Some are over 20 years old. As a result,

flood levels that were predicted before Hurricane Katrina were more than ten feet too low in areas like Hancock County, Mississippi. Moreover, the areas of predicted high-risk were much too small. Many who appeared to be “outside” the flood plain were actually in it and should have been required to buy flood insurance coverage. Since rates and mitigation requirements are based on these maps, taxpayers are subsidizing unwise construction as a result.

Problems with the National Flood Insurance Program are so dire that in an Op Ed in the *New York Times* (attached) and in testimony before the Senate Banking Committee,¹ CFA raised the frightening possibility that it might have to be ended. If the program encourages unwise construction in flood plains, it is a danger to the nation rather than a blessing. If the program lures people into these risky areas and can’t stop communities that defy the program’s mitigation requirements or it falsely assures people that they are in a low-risk area that does not need flood insurance, then either it must be reformed to keep the promises of safer construction made to the taxpayers when the program was begun or it must be abolished.

Congress should stick to trying to repair this program and to proving to taxpayers it can actually end subsidies of unwise construction. It should bring the program into fiscal soundness before thinking about expansion into the wind insurance field. If the NFIP cannot be made fiscally sound, it should be terminated by Congress. Indeed, we call on Congress to require FEMA to complete a report within a year as to how to end the NFIP in an orderly fashion. This report should give special consideration as to how Congress would provide assistance to low and moderate income households that cannot afford flood insurance if the NFIP is terminated.

The Federal Government has no Mitigation Program for Wind Losses in Place

FEMA has been unable to keep the NFIP from creating huge taxpayer subsidies even when the method for mitigating flood risk is well developed. FEMA has mismanaged that mitigation effort by having out-of-date maps and by not taking firm action to make sure that communities strictly enforce the land use measures that they have adopted. For example, Congress wisely adopted a rule requiring that if a home was 50 percent or more damaged by any cause, the home would become a non-conforming use and be required to be elevated to the level of a large “100-year” storm. After Hurricane Katrina, engineers in New Orleans found many homes that were 50 percent or more damaged. After they realized the consequence of their findings, officials in New Orleans offered many homeowners 49 percent certificates instead, with no engineering review required. FEMA, while aware of this flagrant violation of its rules, has done nothing to make New Orleans correct it.

With wind, there is no mitigation program in place. H.R. 1264 would create one in the future, while allowing multi-peril policies with wind coverage to be written today. This is a clear opportunity for developers to build unsafe structures while FEMA tries to develop a mitigation plan, get the communities to adopt it and make sure that the plan, once in place, is actually enforced. Even if they had a plan, FEMA would almost surely mismanage it as it has the flood mitigation effort, resulting in even greater taxpayer subsidies.

¹ Hunter, Robert J., Testimony before the Senate Committee on Banking Housing and Urban Affairs, “Oversight of the National Flood Insurance Program,” October 18, 2005 (available at http://www.consumerfed.org/pdfs/Flood_Insurance_Senate_oversight_testimony_101805.pdf).

Conclusion

It would not be wise for the federal government to get into another program covering insurance risk, particularly with higher policy limits for the coverage that would be allowed under the bill. However, if such a role is contemplated, a number of important minimal conditions should be met first. As we have already mentioned, the NFIP should be put back on firm financial footing. Significant measures must also be taken to ensure that loss of property is clearly and demonstrably reduced. All at-risk properties should be insured for all risks covered by the program and rates should be actuarially sound, with no cross subsidies. The role of the private sector must be maximized and closely regulated. Insurers must not be allowed to adversely select against the program by selecting the lowest risks and leaving the highest risks to taxpayers. Government at the local and state level should also assume financial risk, as a way to provide financial assistance to federal taxpayers and as an incentive for these governments to ensure that home builders and developers abide by building restrictions. Finally, federal financial involvement should be clearly defined and strictly limited. (Please see the attached, "Principles for Protecting Consumers and Taxpayers under a Federal Catastrophe Insurance Program.")

Sincerely,



J. Robert Hunter
Director of Insurance
Consumer Federation of America

cc: Members of the House Financial Services Committee



Consumer Federation of America

PRINCIPLES FOR PROTECTING CONSUMERS AND TAXPAYERS UNDER A FEDERAL CATASTROPHE INSURANCE PROGRAM

The Consumer Federation of America (CFA) has previously opposed proposals to provide federal reinsurance with taxpayer funds for natural catastrophes. This is because these plans have either directly subsidized insurance companies or have provided below-cost insurance to high-risk areas, which would likely spur an increase in unwise construction. Congress should not expand the federal role in providing catastrophe insurance assistance until the federal government fixes the significant flaws that already exist.

- a) **The National Flood Insurance Program (NFIP) must be repaired and functioning smoothly before proposals to expand federal back up to cover other disasters can be taken seriously.** Mitigation is clearly not working under the NFIP. Too many new structures in high-risk areas are being built. Significant insurance subsidies are available to these structures because of problems like antiquated maps indicating much lower flood risk than is currently likely. Insurance rates are based on these erroneous maps, creating a subsidy for new construction and misleading homeowners and business owners into thinking their property is safe. The penetration of flood insurance in at-risk areas under the NFIP is also very low. Too many Americans who live in flood plains are not insured for the flood risk. Moreover, the NFIP allows insurers to charge too much for servicing insurance policies without assuming any financial risk. Some insurers even get windfall payments for commissions when no agent is involved.

CFA is very concerned about any federal catastrophe insurance proposal that would duplicate the kinds of serious problems that exist in these programs. In order to be fair to consumers and taxpayers, any proposal that is offered must conform to the following principles:

Loss of life and property must be clearly and demonstrably reduced.

- Mitigation measures must strictly prohibit construction in extreme risk zones and control construction in all other risk zones.
- Actuarial rates should be charged for each property.
- GAO should monitor compliance on an ongoing basis.
- The federal government should invest in loss prevention instead of spending money after a catastrophic event occurs. It should provide grants and loans to state and local

governments to carry out mandatory loss prevention activities and should provide loans to consumers and businesses for loss prevention investments and retrofits.

All at-risk properties in the nation should be insured for all risks.

- Insurance must be required on all properties to achieve maximum spread of risk and to ensure that uninsured properties do not exist after a catastrophic event.
- Insurance companies writing property coverage in the nation must be required to take all homeowners and small business property risks that meet national mitigation standards for disaster risk.
- All risk coverage on new construction should be initially provided for five years on a policy purchased by the builder and sold along with the structure.
- Reasonable deductibles and limits should be standardized under policy terms set nationally. Persons seeking lower premiums through higher deductibles and other changes to the base policy should be able to do so by signing an agreement that no disaster assistance will be sought for losses in amounts below the higher coverage levels.

Rates should be actuarially sound. There should be no subsidies or cross subsidies.

- Rates on insurance for new construction must be fully actuarial so that new construction that is higher risk will pay its own way and unwise construction will be deterred.
- Rates on insurance for existing construction must be fully actuarial and disclosed at the time of sale so that people buying unsafe structures have fair warning.
- Rates should be adjusted over a reasonable period of time to repay any monies contributed by local, state or federal taxpayers after a catastrophic event.

The role of private sector insurers should be maximized.

- Insurers must make insurance available and be responsible for losses up to a specified insurer deductible. Insurers should be instructed to set up pooling arrangements where they can reinsure business at the insurers' option by sending the loss portion of the premium to the pool. The pool should be monitored to verify that state approved actuarial rates were properly applied to the property.
- The initial insurer deductible for the first year of this program should be \$100 billion, indexed to inflation in home prices nationwide on a year-to-year basis. To ensure that all regions of the country will have reinsurance protection and that small insurers benefit from the program, it should require the establishment of a national pool to reinsure all homes and small business properties in the nation over retentions of 15 percent of premiums in the impacted line by insurer group. Each insurer would be required to forward the appropriate part of the premium to cover the claims sent to the pool. These

premiums would be earmarked for disaster payments only and held as reserves for such an event. These reserves would not be subject to federal income taxes.

Government at all levels should carefully regulate the program.

- Local governments have the key role of enforcing land-use requirements.
- State governments should regulate both policy forms and prices. This will assure consumers that models and other methods used to rate the business are fair and do not result in excessive charges. It will also assure taxpayers that there are no subsidies in the rates. Regulation should follow the detailed methods in use in California under Proposition 103 regulations. State regulation should be monitored by the GAO to assure that it is competently and efficiently performing this important oversight role.
- The federal government should determine the best, most efficient mitigation standards. Local governments should enact and enforce these strict mitigation standards, subject to state audit of compliance and GAO review of the effectiveness of the implementation of these mitigation standards in high-risk areas.

Federal, state and local governments should assume financial risk.

- Local governments should agree to pay 5 percent of costs over the insurer deductible on damage to new construction, as an incentive to encourage rigorous enforcement of land use standards. Bonds could be used for this purpose.
- State governments should contribute a 10 percent layer over insurer and local deductibles. Bonds could also be used for this purpose.
- The federal government should back up the system over the insurer, local and state layers.
- This plan must be designed so that long-term costs to local, state and federal taxpayers will be equal to or less than zero. This means that, as stated above, rates should be actuarially sound to insure that the program is profitable to taxpayers in the long run, or at the very least, does not cost the taxpayers anything.
- No disaster relief should be given to those homes or businesses that should have been insured for coverage but were not, or were inadequately insured. Disaster relief should no longer cover deductibles of insurance policies.

All stakeholders must give up something to make this type of plan work.

- Insurers give up the right to choose to underwrite if mitigation standards are met (i.e., to make sure that insured homes meet construction and loss prevention standards). They must be subject to high quality regulation of price, product, underwriting and claims service.

- Property owners in high-risk areas give up the right to unfettered use of their land unless strong mitigation standards are met.
- Developers give up the right to loosely regulated construction. They must be required to build wisely in risk zones and to arrange for the initial insurance coverage for the first five years.
- Consumers give up their right to take a chance on being uninsured for low frequency/high severity events. Consumers must pay actuarial prices for the coverage, prices that can be very high.
- Government must take on mapping of risk and monitoring to assure compliance with mitigation and actuarial soundness standards. Government must have the ability to obtain funds for the catastrophic back up of the private insurance market.

A fair process and affordable insurance must be ensured.

- One way to ensure that lobbying by private interests does not result in taxpayers shouldering an unjustifiably large portion of the risk in such a program would be to set up a Congressional commission modeled after the base closure commission, which would present Congress with a plan that it could either vote for or against.
- Requiring insurers to offer actuarially sound rates will make it difficult for some low and moderate-income households to afford catastrophe insurance. It will likely be necessary to establish a transitional program to help these consumers afford insurance payments.

New York Times

OP-ED CONTRIBUTOR

False Claims

By J. ROBERT HUNTER

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Washington

IN mid-April, the Federal Emergency Management Agency released its long-awaited guidelines for rebuilding homes and businesses in New Orleans. Americans throughout the country should pay attention, because although these requirements were devised with the best of intentions to spur the reconstruction of a devastated city, they will have negative repercussions far beyond Louisiana.

The new guidelines will cripple FEMA's National Flood Insurance Program, which is the only assistance available to most Americans trying to protect themselves from flooding caused by natural disasters. They will also cause taxpayers to subsidize dangerous and improper rebuilding in New Orleans, putting many residents in harm's way.

The National Flood Insurance Program, which I administered from 1974 to 1978, was introduced in 1968 as a way to assist families devastated by flooding and to encourage safe construction in flood plains. Communities on flood plains receive taxpayer-financed insurance subsidies on existing buildings, in exchange for which they must use their land and construct new buildings in ways that reduce the risk of flood damage.

The program discouraged such communities from building in areas vulnerable to hurricane storm surges, for example, or where water rushes at high velocity when rivers overflow. New buildings in safer parts of flood plains were to be elevated to at least the level of a flood that had a 1 percent chance of happening in a year — the so-called 100-year flood. The program also requires that homes and businesses be raised to the 100-year flood level after suffering damage of 50 percent or more of their structural value.

Taxpayers will subsidize more than \$20 billion in flood insurance claims for the victims of Hurricane Katrina. This is as it should be; residents purchased policies for exactly this purpose. But now it seems that the National Flood Insurance Program is not living up to its promise to reduce flood damage. Significantly, FEMA's flood risk maps are old — in some cases two decades old — and grossly underestimate the hazards. My research on Hancock County in Mississippi shows that the 100-year flood levels predicted on the old maps are about 10 feet below what new maps forecast.

By allowing the maps to get so out of date, FEMA has misled people into building houses at levels that appear to be safe but are not. In some cases, the low projected flood levels also mislead people into thinking that they live outside the flood zones. As a result, they fail to purchase the flood insurance they need.

FEMA's new guidance for the area bounded by the New Orleans levees will allow rebuilding even though, as the agency has stated, "the flood control system will not meet the standards necessary for providing protection" against a 100-year flood. People whose houses sustained less

than 50 percent damage can rebuild where they were. Those with more than 50 percent damage have lined up at City Hall to talk inspectors into altering damage assessments and thus avoid elevating their homes.

Those whose certificates still state that their homes were more than 50 percent damaged — many had water over their roofs — will be allowed to rebuild at elevations dictated by the old maps or lifted a mere three feet higher than they were before the flooding, whichever is greater. New maps for New Orleans won't be released for six more months. Some parish officials have indicated that they may not enforce even this inadequate interim standard.

The desire to help the displaced residents of New Orleans return is understandable, but to do so at the expense of the National Flood Insurance Program's principles of safe construction is shortsighted, dangerous and costly. In order to protect the lives and livelihoods of the city's residents and not saddle taxpayers with avoidable insurance claims, houses in New Orleans must be built above the new 100-year level.

There is a way to maintain National Flood Insurance Program standards and help New Orleans rebuild quickly. First, Congress should require FEMA to enforce all of the standards. Second, Congress should provide the generous financial assistance necessary to help the people of New Orleans raise their homes or move to higher, safer ground. We do nobody in New Orleans a favor if residents are allowed to rebuild in a way that puts their property — or lives — at risk.

If FEMA does not enforce the standards, Congress should end the National Flood Insurance Program. No flood insurance is better than continuing to have taxpayers subsidize unsafe construction in the nation's flood plains.

J. Robert Hunter, the director of insurance for the Consumer Federation of America, is the former federal insurance administrator and Texas insurance commissioner.