



Property Casualty Insurers
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**TESTIMONY SUBMITTED
ON BEHALF OF THE
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA**

***“THE NATIONAL FLOOD INSURANCE PROGRAM:
OVERSIGHT OF SUPERSTORM SANDY CLAIMS”***

**BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES
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Thank you Mr. Chairman, Ranking Member and Members of the Committee for the opportunity to provide testimony on "The National Flood Insurance Program and Oversight of Superstorm Sandy Claims." The Property Casualty Insurers Association of America (PCI) is composed of almost 1,000 member companies, representing the broadest cross section of insurers of any national trade association. Our members write more than \$183 billion in annual premium and 35 percent of the nation's home, auto and business insurance, reflecting the diversity and strength of the U.S. and global insurance markets. PCI members include two-thirds of the "Write-Your-Own" (WYO) insurers that partner with the Federal Emergency Management Agency (FEMA) to administer the National Flood Insurance Program (NFIP).

PCI appreciates the continuing interest of the Committee in the National Flood Insurance Program. While the program has undergone numerous changes over the past several years PCI and our members are ready to work with Congress on continuing improvements to the program to better serve consumers. This testimony provides a broad overview of the evolution of the program, private sector involvement in providing flood insurance coverage, and some of the lessons learned from the response to Superstorm Sandy.

Evolution of Flood Insurance and the Private and Public Sector Roles

Flood insurance was provided in the United States by the private sector in the late 1800's and early 1900's. After catastrophic floods in 1927 and 1928, private flood insurance became decreasingly commonplace. Flood losses were borne primarily by consumers and, over time, increasingly by the federal government in the form of disaster relief. President Truman in the 1950's proposed a flood program based on private insurance with federal reinsurance, with mandatory purchasing required for homeowners with federally insured mortgages. The program was enacted but never funded or implemented. Critics at the time were concerned about adverse selection with most homeowners unwilling to voluntarily pay risk-based rates, a high concentration of risks, and inadequate land-use planning and mitigation efforts. In 1966, President Johnson raised with Congress four possibilities for providing flood insurance – purely private sector underwriting, private underwriting with government backing, a purely government program, or a government program run with private assistance. The Administration ultimately recommended a public-private partnership for offering flood insurance, although requiring homeowners to bear their full risk costs.

In 1968, Congress created the National Flood Insurance Program that provided for a public-private partnership with communities agreeing to land-use restrictions in order to be eligible to purchase flood insurance from a risk pool (the National Flood Insurers Association) run by the private sector with oversight by the Federal Insurance Administration (FIA), then part of the Department of Housing and Urban Development (HUD). The federal government made loans to the private pool to pay claims, repaid with premiums over time, as well as providing reinsurance for catastrophic flood losses (lowering the premiums by eliminating the catastrophic risk costs). An explicit subsidy was provided for existing structures determined to be in a special flood hazard area with the expectation that those structures would disappear over time after severe weather events.

In 1977, disagreements between the private sector and the government over the authority and the financial control of the program led to the FIA exercising an existing section (Part B) of the

1968 legislation that allowed for an all federal program in which the federal government bears all of the risk while making use of insurance industry resources. This also led to a period of tension between the industry and NFIP. In 1979, President Carter created the Federal Emergency Management Agency (FEMA) and the NFIP, along with several other disaster-related agencies were brought into that Agency.

From 1977 through 1983, property owners purchased flood insurance through an agent that in turn dealt directly with the federal government. However, during these early years, there was extremely limited participation in the NFIP, despite a congressionally imposed requirement in 1973 that all properties in a flood zone with federally backed or regulated mortgage purchase flood insurance. On its own, the federal government lacked adequate marketing and distribution channels as well as sufficient claims handling and payment capacity.

In 1983, the government turned again to the private sector to help market, service and settle claims for the program. The "Write-Your-Own" (WYO) program was created to use the existing private insurance infrastructure of insurance agents, companies and claims adjusters to help increase market participation and settle claims, while the risk of flood loss was retained by the government to keep premiums low. Participation in the flood program ultimately soared, climaxing at a post-Katrina high of 5.7 million NFIP policyholders.

How the NFIP and Write Your Own (WYO) Claims Process Works

Roughly 80 of the more than 1300 active home, auto and business insurers in the U.S. have agreed to help administer the NFIP program as Write Your Own (WYO) insurers. WYO's act as a fiduciary for the federal government and taxpayers to market flood insurance and settle flood insurance claims. In return for their marketing, claims adjustment, legal fees and other administrative costs, NFIP pays WYO's a servicing fee as well as additional fees based on the amounts and volume of settled claims. Approximately 12-14 percent of flood insurance policies are written directly by the NFIP Direct Program, although even the direct program relies largely on outsourced claims adjusting and processing resources as well as private sector agents.

Decisions on federal flood insurance claims payments are made by claims adjusters. When policyholders experience a flood loss, they contact their insurance agent or WYO insurer. The insurer then assigns a flood claims adjuster, who may be an employee of the WYO, a contractor with a third party vendor or an independent contractor. The flood claims adjuster determines the amount payable on a claim based on very specific guidelines and rules established by the NFIP. Flood claims adjusters and the independent contracting firms they represent are generally compensated in proportion to the amount of the loss paid. The compensation formulas are set by the NFIP and periodically updated.

WYO insurers can be penalized for either underpayments or overpayments, and WYOs are audited regularly by the federal government under the Improper Payments Elimination and Recovery Act (IPERA) to ensure that they follow federal requirements. WYOs also have strong incentives to pay the right amount to maintain their reputation and consumer retention.

Federal compensation and settlement guidelines are periodically adjusted by Congress and the NFIP. For example, following Hurricane Katrina the Government Accountability Office (GAO) raised concerns that the existing compensation structure could result in WYOs being overcompensated for claims settlement, particularly following a catastrophic event. As a result, the claims compensation formula was refined in 2009 by reducing the portion tied to the claim value and basing a portion of the payment on the WYO insurer's NFIP premium volume. There are also specific processes in place for dissatisfied policyholders to appeal claims decisions to the NFIP. The most recent, admittedly imperfect appeals process was put in place as a result of the enactment of the Flood Insurance Reform Act of 2004.

Recent Challenges in the WYO Program

Administering and marketing the NFIP is very complex and expensive, particularly with numerous recent statutory changes to the program (many retroactive). The number of private participants in the WYO program has declined significantly in recent years, with several current participants preparing to exit the program after the recent changes. Most WYOs sell and administer a small number of NFIP policies, largely as an extra service to their consumers. The recent turmoil in the program has further increased costs and reputational concerns, weighing heavily on insurers ability to continue offering access to the NFIP as a service for their policyholder. While the NFIP's Brad Kieserman stated at the April Senate ad hoc Sandy Claims Task Force meeting that FEMA has "seen no evidence of wrongdoing by insurers who handled Sandy claims," there have been demands for WYOs to make Sandy flood litigation payments to policyholders that the DHS General Counsel determined the NFIP could not legally pay out of the National Flood Insurance Fund.

PCI and our WYO members are also concerned about the increasing polarization and uncertainty over the future of the program. Unfortunately, as WYO private participation in the program has declined and many of the recent legislative changes have been implemented, the number of households and businesses in the program has also dropped significantly. Sadly, after nine years (2006-2013) of having about 5.6 million policies in force, the NFIP's number of policies in force is now about 5.2 million and continues to fall.

Lessons Learned from Superstorm Sandy and Potential Areas of Reform

While Superstorm Sandy was a significant storm causing tragic human and physical losses, it was not significantly different from other large-scale natural disasters with regard to the litigation that ensued. Almost 99 percent of the flood loss claims (142,000+) have been settled and only 1.04 percent remain in litigation. Of course, no level of wrongdoing is acceptable and to the extent that Sandy claims differ in this regard, they should be treated differently. However, there are several lessons that the marketplace learned or relearned in the aftermath of Sandy that Congress might revisit.

Governmental Coordination

In the immediate aftermath of a natural catastrophe it is critical for local, state, and federal officials to coordinate their efforts to get basic services up and running as quickly as possible, to get people back to their homes, and to get businesses to begin remediation and rebuilding. Insurers need

to be at the table during pre- and post-disaster emergency planning and coordination to ensure that smooth claims adjustment can be a part of the catastrophe response planning. It is also essential to the rebuilding process that local law enforcement and government officials allow insurers and insurance claims adjusters into damaged areas as soon it is safe -- at least as soon as property owners are provided access. Following Superstorm Sandy's landfall, despite being granted authority by the states, insurance personnel access to affected areas was denied.

Available Claims Adjusters

A unique aspect of Superstorm Sandy was the lack of locally licensed flood insurance adjusters willing to adjudicate Sandy losses, which delayed the claims settlement and the rebuilding process. Most flood insurance adjusters are located in areas that frequently flood, while Superstorm Sandy hit regions that flood less frequently. Many states implement reciprocal recognition of claims adjusters from other states to help, and the state insurance department grant such access if the proper credentials are provided. However, it can often be difficult in the middle of a catastrophic event with an unusual number of claims to process the necessary paperwork in a timely manner. PCI supports federal legislation to require more reciprocal claims adjuster recognition.

Engineering Reports

Another unique feature of Sandy was the need for more engineering reports due to the prevalence of below ground building substructures. There are a limited number of engineering firms. With both non-flood and flood insurers requiring engineering services after any catastrophe, engineering firms necessarily encounter challenges managing both the volume of work as well as the short time frames for adjusting claims due to media and public official pressures. Engineering on-site inspectors are not always familiar with the particular requirements and guidelines of the NFIP. One of the engineering subcontractors, used by both the NFIP Direct Program and some WYOs has been accused of altering the reports of one of its on-site inspectors. Subsequent to these allegations, the NFIP has worked to facilitate remaining open claims and allow unsatisfied claimants to have their claims reviewed by NFIP staff.

Balancing the Pendulum of Overpayment and Underpayment Concerns

Congress and the NFIP have periodically revisited the flood program's guidelines to balance concerns about the risks of overpayment and underpayment. After hurricane Katrina, the Department of Homeland Security's Office of Inspector General released a report considering allegations that insurers were overpaying consumers. While the Government Accountability Office (GAO) in a subsequent investigation concluded that they found no evidence of inappropriate attribution of losses, FEMA reviewed the settlement guidelines. The criticisms after Sandy have been of underpayment rather than overpayment. However, PCI and our WYO members welcome a thorough review of the claims settlement process to ensure the optimal fiduciary balance between protecting policyholders and taxpayers.

Mitigation

Preparation is a key factor in minimizing financial loss after a natural catastrophe. Strong,

uniform statewide building codes that are regularly updated play a significant role in reducing the risk of injury or death to homeowners during a natural catastrophe. Structures built or retrofitted to comply with the most recent edition of the *International Building Code*, and other recognized building standards, incur less property damage during a significant weather event. Less property damage following an event reduces the need for federal disaster aid and can help expedite a community's recovery after a natural catastrophe. PCI promotes strong building codes and responsible land use policies, which are crucial for all stakeholders, to promote public safety and to be as prepared as possible for the next hurricane, tornado, or flood disaster. Updating flood maps immediately following such an event may be critical to ensuring that homes and businesses being rebuilt meet the appropriate flood elevation criteria.

Private Sector Participation

PCI also supports increasing consumer choice in flood insurance. In particular, PCI supports legislation facilitating a consumer's choice to choose private flood insurance that can be accepted as conforming by mortgage lenders. Also, PCI notes that the recent Biggert-Waters and HFIAA flood reform legislation authorizes FEMA to obtain reinsurance from the private market, although this has not yet been pursued. PCI believes that there are additional challenges and opportunities in this area and looks forward to working with Congress in reviewing opportunities for expanding coverage and protections for consumers.

Program Growth and Risk Spread

A number of Sandy losses were not covered by insurance, often because homeowners were not aware of the risks or the potential gaps in their existing coverage, or because they were simply uninsured or underinsured. There are additional opportunities for the government and private sector to educate consumers about flood insurance and reduce future gaps and consumer vulnerabilities.

Ongoing Discussions of NFIP Reforms

As we look towards the reauthorization of the NFIP program in 2017 and Congress considers short and long-term changes to it we have already started to discuss such reforms. PCI hosted the 2015 National Flood Insurance Conference in mid-May that included all the stakeholders in this program. That conference agenda included potential program improvements, other approaches to address the risk, technical issues and challenges to private sector participation and risk bearing. PCI will continue these discussions with stakeholders and would welcome further conversations on improvements with regard to oversight and operation of the NFIP with the Committee.

Conclusion

The flood insurance program protects millions of American businesses and families from catastrophic flood risk. PCI members and our WYO companies appreciate the opportunity to service the federal government and consumers and welcome a discussion with the Committee about how to improve the claims process and shape the program in the future.