AmWINS Group, Inc.

CLIENT ADVISORY

10 KEY CHANGES FOR THE PRIVATE COMMERCIAL FLOOD MARKET

It is no secret that the National Flood Insurance Program (NFIP) is dramatically reducing its subsidies for commercial flood insurance. Political ramifications and public policy issues aside, if NFIP didn't have the ability to borrow from the U.S. Treasury to pay claims, it could not exist as a commercial carrier. But what is next? What needs to be done? Is there a private market solution? What options are available?

Created by a Congressional act in 1968, NFIP is the principal flood market for residential and commercial insureds. Prior to Hurricanes Ivan, Katrina, Rita and Ike, NFIP took in more premium than it paid out in claims[1], creating a surplus that was wiped out by the those storms. By 2012, the NFIP was $20.7 billion in debt. When Superstorm Sandy hit in October 2012, that figure surged to over $30 billion.[2]

These losses are only part of the story. Mandatory purchase requirements, statutory caps on premium increases, the legislative mandate of FEMA, lack of capital requirements or need to earn a profit, and subsidized premiums that do not reflect risk exposures have all contributed to NFIP's instability and dysfunction as its deficit balloons.

According to FEMA, there is an estimated $3.3 billion in annual premium paid to NFIP. Certainly, this creates an incentive for the private sector and one of the largest growth opportunities in the property and casualty market today. Can the challenges causing NFIP's problems be adequately addressed by the commercial market? A 2014 report released by the Government Accountability Office (GAO) indicated that private insurers are not likely to write flood insurance without reforms, including the ability to charge adequate risk-based premium.[3]

CONTACT

To learn more about how AmWINS can help you place coverage for your clients, reach out to your local AmWINS broker or marketing@amwins.com.

Historically, commercial insurers have provided limited flood insurance either as excess capacity attaching above NFIP limits or as sublimits within large sophisticated risk management programs. Wide scale participation has been hampered by the same core issues that have undermined NFIP. These issues underscore the differences between NFIP and the commercial market:

- NFIP is federally regulated and not subject to individual state regulations.
- NFIP terms and conditions are determined by federal statute.
- NFIP is not subject to capital or solvency requirements.
- NFIP does not invest surplus to generate income.
- NFIP does not purchase reinsurance.
- NFIP subsidizes certain risks by not charging actuarially sound rates.[4]

In their latest attempt to address some of these issues, Congress enacted the Biggert-Waters Flood Insurance Reform Act of 2012. While the Act was modified by the Homeowner Flood Insurance Affordability Act of 2014, those changes addressed personal lines and did not significantly affect the commercial market. Some of the key changes which have advanced the private commercial flood market include:

1. Phase out of Pre-Flood Insurance Rate Map (FIRM)[5] subsidies for properties that experience severe repetitive loss, or properties that were substantially damaged or improved.
2. Provide rate increases of 20% per year until "full-risk rates" are achieved for pre-FIRM subsidized properties.
3. Mandate the study of privatization through the use of reinsurance and capital markets.
4. Allow use of Community Development Block Grant to fund local staffing and building code enforcement.
5. Require Federal Insurance Office and Government Accountability Office to provide a report to Congress on options and way to further privatize flood insurance.

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6. Establish National Flood Insurance Reserve Fund.
7. Clarify that private flood insurance may satisfy flood insurance requirements if it meets certain standards.
8. Allow state-sponsored non-binding mediation for claim disputes.
9. Amend the Real Estate Settlement Procedures Act (RESPA) to require an explanation of the availability of flood insurance through NFIP or private insurance.
10. Establish an ongoing National Flood Mapping Program.

While more change is needed, these accomplishments have served to promote the growth of private sector flood insurance.

At AmWINS, we believe the privatization trend will continue and we are investing resources to provide our clients with competitive alternatives to NFIP, including dedicated in-house facilities. AmWINS' property brokers are current on the latest market developments and are prepared to guide retail agents and brokers – and their insureds – through this often misunderstood line of coverage.

This article was authored by Harry Tucker, co-leader of AmWINS' national Property Practice.

[1] *"Flood Insurance – Strategies for Increasing Private Sector Involvement". GAO, January 22, 2014.*

[2] *"The National Flood Insurance Program: Status and Remaining Issues for Congress Congressional Research Service". February 6, 2013.*

[3] *"Flood Insurance – Strategies for Increasing Private Sector Involvement". GAO, January 22, 2014.*

[4] *"The potential for flood insurance privatization in the U.S. Could carriers keep their heads above water?" Deloitte & Touche, 2014.*

[5] *Author's note: Pre-Flood Insurance Rate Map (FIRM) buildings are those built before the effective date of the first Flood Insurance Rate Map (FIRM) for a community. This means they were built before detailed flood hazard data and flood elevations were provided to the community and usually before the community enacted comprehensive regulations on floodplain regulation.*