MEMORANDUM

Date: March 29, 2006

To: The Honorable Juan Vargas, Chair
Members, Assembly Insurance Committee

From: Rex D. Frazier, Vice President & General Counsel
Michael A. Gunning, Vice President
Michael A. Paiva, Senior Legislative Advocate

Re: AB 1898 (Jones): Flood Insurance
Assembly Insurance Committee: April 5, 2006
PIFC Position: Concerns

The Personal Insurance Federation of California (PIFC), representing insurers who write 55% of all homeowners' insurance sold in California, supports efforts to increase the number of property owners who purchase flood insurance. However, PIFC believes the best way to accomplish this objective is for the state of California to work with the Federal Emergency Management Agency (FEMA). In addition, PIFC has identified **several areas of concern relative to AB 1898** (Jones) which proposes to institute a mandate to purchase flood insurance for all property owners with less than 200-year flood protection.

Premature. PIFC believes there is not enough information about the possible impacts an expanded mandate to purchase would have on the National Flood Insurance Program (NFIP). In late 2005, a broad range of stakeholders including insurers, realtors, builders, and lenders convened meetings in Washington, DC and produced a list of "Consensus Reforms" relative to the NFIP. On the issue of mandating increased participation, the group recommended that the Government Accountability Office (GAO) or another Federal government entity, conduct a study in order to ascertain the impact of such action.

…the GAO should study how these mandates are likely to affect participation, pricing, and the integrity of the program, and housing and regional markets. It may well be that increased participation could increase risk spreading, decrease adverse selection, and perhaps reduce premiums. But before any such changes are made, a study, with input from actuaries knowledgeable about the NFIP makes sense.

PIFC agrees with the measured approach outlined in the "Consensus Reforms." (A copy of the Consensus Reforms is attached.)

Preemption. PIFC believes it is inappropriate for California to act unilaterally to expand a federal program. Two PIFC member companies write flood insurance through the Write Your Own (WYO) program. A private insurer becomes a WYO company by entering into an Arrangement with the federal government to act as

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its “fiscal agent” and “fiduciary” in the context of selling flood insurance. As a result of this Arrangement, PIFC asserts that its member companies would likely be prohibited from complying with provisions of this bill calling for an expansion of the federal mandate to purchase.

In addition, when disputes have arisen between NFIP policyholders and WYO companies, courts have generally held that the federal government alone should direct and regulate <u>all</u> NFIP-related operations, not just claims handling. The passage below is from the California appellate court’s decision in *McCormick v. Travelers Ins. Co.,* 103 Cal. Rptr.2d 258 (Cal. App. 1st. Cir. 2001), review denied:

> *We see no basis for turning the jurisdictional question on a distinction between errors allegedly committed while explaining the scope of coverage to a new policyholder and errors allegedly committed in interpreting the amount of insurance proceeds to which the policyholder is entitled following a loss. The breadth of activities WYO insurers pursue in furtherance of the NFIP encompasses procuring policies, servicing the accounts, and processing claims. At all of these stages of the insured/insurer relationship, the workings of the NFIP are intimately involved. Moreover, treating some claims as exclusively within the jurisdiction of the federal courts and some within the concurrent subject matter jurisdiction of state courts invites the very Balkanization of lawsuits FEMA forecasts with justifiable dread in its amicus brief.*
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> *Therefore, were we to follow Moore, we would necessarily put our imprimatur on the McCormicks’ strategy of allowing them to litigate in a federal forum their coverage dispute (which a state court unquestionably does not have jurisdiction to decide), while allowing their misrepresentation and related state claims to repose in state court awaiting the outcome of the federal action. Surely, this orphaning of the “child of Congress” to 50 state court jurisdictions was not the intention of Congress in establishing “a pervasive and comprehensive scheme of federal regulations setting forth the rights and responsibilities of insureds and insurers under the NFIP. Id. at 268*

Given the court’s clear signal that NFIP issues should be adjudicated in federal court, PIFC believes that a federal approach to expansion issues is also preferred, and probably required.

Funding Crunch. PIFC believes it is inappropriate to add more California properties to the NFIP prior to a thorough study of such a move, especially given the program’s current precarious financial condition.

The NFIP is overseen by FEMA and funded through the National Flood Insurance Fund within the U.S. Treasury. It is intended to be a self-supporting program for the average historical loss year. However, FEMA is authorized to borrow up to $18.5 billion from the Treasury when NFIP losses are heavy, although these loans must be repaid with interest.

In 2005, losses to the NFIP were more than "heavy," they were monumental. In fact, losses in 2005 were nearly 15 times more than the $2 billion the program collected in premiums in 2004. According to the Insurance Information Institute (III), if the NFIP were a private insurer, it would be "bankrupt." In order to continue paying claims, FEMA has sought and received two supplemental loans from the U.S. Treasury totaling $18.5 billion and has indicated there is a need for at least an additional $5 billion.

But, according to sources in Washington, obtaining these loans was not easy and the loans have come with a political price tag. Members of Congress from states not impacted by flooding are starting to question whether flood-prone states should allow for the rebuilding of homes and businesses in areas that have flooded in the past.

Furthermore, PIFC believes it is reasonable to assume that other states will object to individual states acting to expand the mandate to purchase flood insurance – at least until the impact of such an expansion is ascertained. At a minimum, a thorough study should be conducted to ascertain the impact of adding more California properties to the NFIP.

In addition, PIFC has serious concerns that AB 1898 will negatively impact the financial viability of the NFIP. This is because this bill not only expands the mandate to purchase flood insurance outside the 100-year flood plain, it also expands the mandate to purchase insurance within the 100-year flood plain.

Current federal rules only require property owners with federally backed mortgages to carry flood insurance. AB 1898 expands this requirement to include *all* property owners. Since many of the rates charged by the NFIP on older properties within the 100-year flood plain are subsidized by the federal government, AB 1898 increases the federal government's unfunded liabilities. As such, it may be in violation of the Appropriations clause of the U.S. Constitution. And it is worth noting that, according to the NFIP, one in four NFIP claims come from outside high-flood-risk areas. When you combine this with the fact that many of the current flood maps are outdated and inaccurate, the notion that adding additional policyholders from areas outside of the 100-year floodplain will actually improve the financial condition of the NFIP may not hold true.

Finally, PIFC notes that in the fall of 2005, WYO companies received a directive from FEMA advising them that they were not to make flood payouts to NFIP claimholders. The directive noted that Congress had not yet approved the additional borrowing authority to keep the program solvent. Ultimately, this directive was reversed when Congress appropriated more money to the NFIP. However, given the fact that WYO companies were put on notice in the fall of 2005 regarding this precarious funding situation, PIFC has grave concerns about a further expansion of the NFIP product until such time as the true impact of such an expansion is known and until such time as the financial wherewithal of the program is fully ascertained.

Insurer Staffing Issues. PIFC raises questions about the impact on insurers of a mandate to purchase in the 200-year floodplain. From an operations perspective, insurers need to know how many new policyholders to expect in order to adequately staff and service those policies. PIFC does not have independent knowledge of the number of properties impacted by the expansion. Once this information is known, insurers will have a better idea regarding the number of new employees that will be needed and the amount of training that might be required. But until such time as this information is gathered, PIFC member companies remain concerned about the type of expansion called for in AB 1898.

Accuracy and Availability of Maps. As of today, no maps exist to accurately reflect the number of properties included in the 200-year floodplain – the area impacted by AB 1898. AB 1898, which is to go into effect on July 1, 2007, specifies that the properties impacted by the bill are to be "determined by maps developed, or approved by, the state Department of Water Resources,…". PIFC questions whether it is realistic to expect that appropriate funding is available to produce accurate maps in such a short period of time. Congress is currently contemplating a 10-year, $14 billion project to accurately map floodplains in all states. Given the high cost estimate and the lengthy time frame for completion, PIFC believes it will take more time to accurately map the floodplain than is allowed by the July 1, 2007 implementation date in AB 1898. Furthermore, PIFC questions whether it is cost effective for the state to undertake a mapping project at the same time that Congress is contemplating a similar mapping project.

Finally, PIFC notes that the accuracy of maps is a critical issue for PIFC member companies. Without accurate maps, insurers will have no way of knowing who is and who is not required to purchase flood insurance. PIFC can easily anticipate litigation following a flood whereby a property owner sues their community, state, lender and/or insurer for failing to provide insurance.

For all of the reasons noted above, **PIFC has a number of concerns with AB 1898**. PIFC is committed to working with the author regarding ways to increase flood protection in areas subject to flooding and in seeking ways to voluntarily increase participation in the NFIP. PIFC looks forward to an opportunity to discuss these issues. If you have any questions, please contact Michael Paiva at (916) 442-6646.

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