HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 895 Flood Insurance
SPONSOR(S): Insurance & Banking Subcommittee; Ahern and others
TIED BILLS: **IDEN./SIM. BILLS:** CS/CS/SB 1094

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	12 Y, 0 N, As CS	Cooper	Cooper
2) Appropriations Committee	22 Y, 3 N	Keith	Leznoff
3) Regulatory Affairs Committee			

SUMMARY ANALYSIS

The National Flood Insurance Program (NFIP) is a federal program that offers federally-subsidized flood insurance to property owners and promotes land-use controls in floodplains. The Federal Emergency Management Agency (FEMA) administers the NFIP. The Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12) made major changes to the NFIP, including an increase in rates charged by the NFIP for flood insurance, starting in 2013**.** However, starting October 1, 2013, some NFIP policies that were subsidized moved directly to full-risk rates, resulting in dramatic flood insurance rate increases for some homeowners. In March 2014, federal legislation was enacted to moderate some of the rate increases resulting from BW-12.

In 2014, the Legislature enacted s. 627.715, F.S., to provide a framework for a private, personal lines flood insurance market in Florida. The section provides for four types of flood insurance: *standard flood insurance* (which is equivalent to a standard policy under the NFIP), *preferred flood insurance, customized flood insurance*, and *supplemental flood insurance*. The section allows insurers to develop rates for flood coverage, by either filing the rate with the Office of Insurance Regulation (OIR) and obtaining approval, or, until October 1, 2019, use a rate without the OIR's approval, so long as the rate is not excessive, inadequate, or unfairly discriminatory. Additionally, surplus lines insurers are permitted (until July 1, 2017) to offer primary flood coverage without the agent having to obtain three declinations from authorized insurers.

The bill amends s. 627.715, F.S., to:

- Create a fifth type of flood insurance, called "flexible flood insurance," which is defined as the coverage for the peril of flood that may include water intrusion coverage, and includes or excludes specified provisions.
- Require that flexible flood policies must be acceptable to the mortgage lender if such policy, contract, or endorsement is intended to satisfy a mortgage requirement.
- Clarify the definition of supplemental insurance to permit coverage in excess over any other insurance covering the peril of flood.
- Provide that the notice that insurance agents must provide to potential insureds must notify the applicant that the full risk rate may apply, if NFIP coverage at a subsidized rate is discontinued.
- Authorizes the OIR to require insurers to provide appropriate return of premium to affected insureds, if the OIR determines a rate is excessive or unfairly discriminatory.
- Allow an insurer to request a certification from the OIR that acknowledges that a private flood policy equals or exceeds the coverage offered by NFIP. Subject to the OIR's verification that such policy is NFIP-equivalent, these certifications may be used in advertising and communications with agents, lenders, insureds, and potential insureds. The bill provides that an insurer or agent who knowingly misrepresents that a flood policy, contract, or endorsement is certified commits an unfair and deceptive act.

The bill has no fiscal impact on state government revenues or expenditures. The bill may have a positive impact on the private sector.

The bill provides an effective date of July 1, 2015.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Current Situation

National Flood Insurance Program

The National Flood Insurance Program (NFIP or program) was created by the passage of the National Flood Insurance Act of 1968 to offer federally-subsidized flood insurance to property owners and to promote land-use controls in floodplains. The NFIP is administered by the Federal Emergency Management Agency (FEMA). The federal government will make flood insurance available within a community, if that community adopts and enforces a floodplain management ordinance to reduce future flood risk to new construction in floodplains.[1]

Nationally, the NFIP provided flood insurance coverage for 5.8 million properties and insured more than $1.3 trillion in assets in 2013.[2] Total earned premium for NFIP coverage for 2012 was $3.5 trillion.

Federal Requirements to Obtain NFIP Flood Insurance

In 1973 the U.S. Congress passed the Flood Disaster Protection Act.[3] The Act required property owners with mortgages issued by federally regulated or insured lenders to purchase flood insurance if their property was located in a Special Flood Hazard Area. Special Flood Hazard Areas are defined by FEMA as high-risk areas where there is at least a one in four chance of flooding during a 30-year mortgage.

The National Flood Insurance Reform Act of 1994[4] (1994 Reform Act) required federal financial regulatory agencies[5] to revise their flood insurance regulations. The 1994 Reform Act also applied flood insurance requirements to loans purchased by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and to agencies that provide government insurance or guarantees, such as the Small Business Administration, the Federal Housing Administration, and the Veterans Administration.[6]

The 1994 Reform Act prohibits federally regulated lending institutions from offering loans on properties located in a Special Flood Hazard Area of a community participating in the NFIP, unless the property is covered by flood insurance.[7] The minimum amount of NFIP flood insurance required by the 1994 Reform Act must be *at least* equal to the outstanding principal balance of the loan, or the maximum amount available under the NFIP, whichever is less.[8] This minimum standard also applies to private flood insurance accepted in lieu of NFIP flood insurance.[9] These provisions do not apply to state-owned property covered under an adequate state self-insurance policy satisfactory to FEMA, or to small loans (defined as having an original outstanding principal balance of $5,000 or less and a repayment term of one year or less).[10]

For properties located outside Special Flood Hazard Areas, lenders on their own initiative may require flood insurance to be purchased to protect their investment. Additionally, it is noted that the Federal Housing

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[1] FEMA, *National Flood Insurance Program, Program Description*, (Aug. 1, 2002), https://www.fema.gov/media-library/assets/documents/1150?id=1480 (last viewed Mar. 26, 2015)
[2] All 2013 NFIP statistics are available at http://www.fema.gov/statistics-calendar-year (last viewed Mar. 26, 2015).
[3] These statutes are codified at 42 U.S.C. §§4001-4129.
[4] Title V of the Riegle Community Development and Regulatory Improvement Act of 1994. Pub. L. 103-325, Title V, 108 Stat. 2160, 2255-87 (September 23, 1994).
[5] The federal financial regulators are the Office of Comptroller of Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Farm Credit Administration, and the Board of Governors of the Federal Reserve System.
[6] *FDIC Compliance Manual*, V – 6.1. http://www.fdic.gov/regulations/compliance/manual/index.html (last viewed Mar. 26, 2015).
[7] 42 U.S.C §4012a(b).
[8] 42 U.S.C. §4012a(b)(1)(A).
[9] 42 U.S.C. §4012a(b)(1)(B).
[10] 42 U.S.C. §4012a(c).

Administration, a federal mortgage insurer, is authorized to require flood insurance coverage higher than the NFIP minimum requirement on FHA-guaranteed mortgages, under the authority of the federal Housing Act.[11]

Standard NFIP Flood Insurance Policies

The standard flood insurance policy dwelling form offered by the NFIP[12] is a single peril flood policy that pays for direct physical damage to the insured residential property up to the replacement cost[13] (RCV) or actual cash value (ACV) or the policy limit.[14] The maximum coverage limit for a NFIP standard residential flood insurance policy is $250,000.[15] The NFIP also offers up to $100,000 in personal property (contents) coverage for residential property, which is always paid at ACV.[16]

The maximum coverage available to a condominium association purchased to cover the condominium building, the common and individually owned building elements within the condominium units, improvements within the units, and contents owned in common is $250,000 per unit multiplied by the total number of units, or the replacement cost of the condominium building, whichever is less.[17] Individual condominium unit owners can purchase flood insurance through the NFIP to insure contents in their condominium unit with a separate dwelling form policy. The NFIP flood insurance coverage limits on non-residential buildings are $500,000 in coverage to the building and $500,000 in contents coverage.[18] Properties that cannot obtain flood insurance through the NFIP or need more coverage (called excess coverage) than that provided by the NFIP can purchase flood insurance from licensed Florida insurers in the admitted market or surplus lines insurers,[19] although availability may be limited.

Most NFIP policies also include increased cost of compliance coverage of up to $30,000 per building for the increased cost to elevate, demolish, or relocate a building to comply with state or community floodplain management laws or ordinances after a flood which substantially damages or repetitively damages the building.[20]

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[11] *Feaz v. Wells Fargo Bank, N.A.*, 745 F.3d 1098 (11th C.A. 2014). The Housing Act confers on the Secretary of the U.S. Department of Housing and Urban Development the authority to prescribe terms for FHA-insured mortgage contracts, such as mandatory covenants requiring a FHA borrower to maintain hazard and flood insurance in amounts required by the lender. In *Feaz*, the Eleventh Circuit interpreted a FHA covenant to permit the lender to require flood coverage <u>above</u> the NFIP minimum (i.e., the lesser of the loan's principal balance or the NFIP maximum of $250,000), to require the lesser of the home's replacement value or $250,000.

[12] The standard form insures one-to-four family residential buildings and single-family dwelling units in a condominium building. The NFIP also offers (a) a general property form that is used to insure five-or-more-family residential buildings and non-residential buildings and (b) a residential condominium building association policy form that insures residential condominium association buildings. *National Flood Insurance Program: Summary of Coverage*, Federal Emergency Management Agency (FEMA F-679/November 2012), http://www.fema.gov/media-library-data/20130726-1620-20490-4648/f_679_summaryofcoverage_11_2012.pdf (last viewed Mar. 26, 2015).

[13] To obtain RCV coverage under the NFIP dwelling form, the building must be a single-family dwelling, be the principal residence of the insured at the time of loss (the insured lives there at least 80 percent of the year), and the building coverage of at least 80 percent of the full replacement cost of the building or its the maximum available for the property under the NFIP.

[14] *National Flood Insurance Program: Summary of Coverage*, Federal Emergency Management Agency (FEMA F-679/November 2012) http://www.fema.gov/media-library-data/20130726-1620-20490-4648/f_679_summaryofcoverage_11_2012.pdf (last viewed Mar. 26, 2015).

[15] 44 C.F.R. §61.6.

[16] *Id.*

[17] 44 C.F.R. §61.6(b).

[18] 44 C.F.R. §61.6.

[19] Unlike insurers in the admitted market, surplus lines insurers are not licensed insurers, do not have their rates regulated by the Office of Insurance Regulation, and do not participate in the Florida Insurance Guaranty Association.

[20] The total amount of a building claim and an increased cost of coverage claim cannot exceed the maximum limit for building property coverage. For a single-family home, this is $250,000. The limit is $500,000 for non-residential structures. See *National Flood Insurance Program: Summary of Coverage*, Federal Emergency Management Agency (FEMA F-679/November 2012). http://www.fema.gov/media-library-data/20130726-1620-20490-4648/f_679_summaryofcoverage_11_2012.pdf (last viewed Mar. 26, 2015).

NFIP flood policies have separate deductibles for building and personal property (contents) coverage, so a policyholder could pay two deductibles if a loss occurs. Generally, for most properties built before the effective date of the first flood insurance rate map[21] for a community, the minimum deductible[22] is:

- $1,000 if the property is located in certain flood zones.
- $2,000 if the property is located in other flood zones.

For most properties built after the effective date of the first flood insurance rate map for a community, the minimum deductible is $1,000 if the property is insured in any flood zone.[23]

Generally, deductibles for most NFIP residential policies can increase in $1,000 increments from the required minimum, with the maximum deductible being $5,000 for building coverage and $5,000 for contents coverage.[24]

The Biggert-Waters Flood Insurance Reform Act of 2012

Following flood losses from the 2005 hurricanes Katrina, Rita, and Wilma, the NFIP borrowed $21 billion from the U.S. Treasury in order to remain solvent. However, flood losses in 2012 from Super-storm Sandy increased the NFIP's deficit. In 2012, the United States Congress passed the Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act).[25] The Biggert-Waters Act reauthorized the National Flood Insurance Program for five years. Key provisions of the legislation require the NFIP to raise rates to reflect true flood risk, make the program more financially stable, and change how Flood Insurance Rate Map updates impact policyholders. These changes by Congress have resulted in premium rate increases for approximately 20 percent of NFIP policyholders nationwide.

The Biggert-Waters Act increases flood insurance premiums purchased through the program for second homes, business properties, severe repetitive loss properties, and substantially improved damaged properties by requiring premium increases of 25 percent per year until premiums meet the full actuarial cost of flood coverage. Most residences immediately lose their subsidized rates if the property is sold, the policy lapses, repeated and severe flood losses occur, or a new policy is purchased. Some flood maps used by FEMA have not been updated since the 1980s. Policyholders whose communities adopt a new, updated Flood Insurance Rate Map (FIRM) that results in higher rates will experience a five year phase in of rate increases to achieve rates that incorporate the full actuarial cost of coverage.

The Reform Act also requires most NFIP policyholders to pay a 5% assessment on their policy to create a reserve fund for catastrophic losses.[26] Additional changes to premium rates, including those paid by the 80 percent of NFIP policyholders with non-subsidized rates, can occur upon remapping. Current law limits rate increases due to remapping to 10 percent per year, so Biggert-Waters allows a larger annual rate increase

[21] The effective date of the first flood insurance rate map (FIRM) for Florida communities can be found at http://www.fema.gov/cis/FL.pdf (last viewed Mar. 26, 2015); *National Flood Insurance Program Flood Insurance Manual*, RATE 16, Federal Emergency Management Agency (Revised Oct. 2013), http://www.fema.gov/media-library/assets/documents/34745 (last viewed Mar. 26, 2015).

[22] The minimum deductible for properties located in any flood zone in the NFIP emergency program is $2,000. The minimum deductible for pre-FIRM properties with optional post-FIRM elevation ratings in any flood zone is $1,000. See *National Flood Insurance Program Flood Insurance Manual*, RATE 14, Federal Emergency Management Agency (Revised October 2013) . http://www.fema.gov/media-library/assets/documents/34745 (last viewed Mar. 26, 2015).

[23] *National Flood Insurance Program Flood Insurance Manual*, RATE 14, Federal Emergency Management Agency (Revised October 2013). http://www.fema.gov/media-library/assets/documents/34745 (last viewed Mar. 26, 2015).

[24] For a full listing of NFIP deductible options, see *National Flood Insurance Program Flood Insurance Manual*, RATE 14-RATE 15, Federal Emergency Management Agency (Revised October 2013). http://www.fema.gov/media-library/assets/documents/34745 (last viewed Mar. 26, 2015). Deductibles for non-residential flood policies can increase to $50,000 for building and $50,000 for contents coverage.

[25] FEMA, Flood Insurance Reform, https://www.fema.gov/national-flood-insurance-program/flood-insurance-reform (last viewed Mar. 26, 2015).

[26] For those NFIP policies with a 25% rate increase, the 5% assessment is not on top of the 25% rate increase. In other words, 5% of the 25% increase will be allocated to the Reserve Fund.

for remapped properties. However, federal action in the 2014 federal omnibus spending bill has likely delayed rate increases associated with remapping for 12-18 months, as described below.

2014 Federal Flood Reform Bills

The Consolidated Appropriations Act of 2014 and the Homeowner Flood Insurance Affordability Act of 2014[27] repealed or modified some provisions of the Biggert-Waters Act. The new law reduced the rate mandatory rate increases for subsidized properties from 25% annually to no less than 5%, generally not to increase more than 18% annually.[28] Properties that remain subject to the 25 percent annual increase include older business properties, older non-primary residences, severe repetitive loss properties, and pre-FIRM properties. The 20% annual phase-in of premium increases after adoption of a new or updated flood insurance rate map was reduced to a maximum of no more than an 18% annual premium increase. For property not currently at a full-risk rate, a minimum increase of 5% per year is required for flood policies on primary residences built on or before December 31, 1994 or before the effective date of the initial flood insurance rate map for the community was adopted.[29]

The policyholder refunds were provided to policyholders whose rate increases were revised by the 2014 changes. Additional revisions included increasing the maximum flood insurance deductibles, directing FEMA to consider property specific flood mitigation in determining a full-risk rate, and creating the position of a Flood Insurance Advocate.

NFIP Flood Insurance in Florida

Over two million NFIP policies are written on Florida properties, with approximately 268,500 policies receiving subsidized rates. This accounts for approximately 37% of the total flood policies written by the NFIP, more than any other state.[30] Eighty-seven percent of the two million Florida policies (1.78 million policies) have nonsubsidized rates, so they will not be subject to the 25% annual rate increases under Biggert-Waters. These policies, however, may see routine annual rate increases and rate increases of up to 20% per year, due to remapping after FEMA is allowed to spend funds on remapping.

From 1987-2008, the NFIP collected $3.60 in Florida premiums for every $1 paid in claims to Florida.[31] The rate impact of the Biggert-Waters Act on subsidized policies in Florida is approximately as follows:

- Approximately 50,000 secondary residences, businesses, and severe repetitive loss properties are subject to immediate, annual 25 percent increases until their premiums are full risk premiums.
- Approximately 103,000 primary residences will lose their subsidy if the property is sold, the policy lapses, if the property suffers severe, repeated flood losses, or if a new policy is purchased.
- Approximately 115,000 non-primary residences, business properties, and severe repetitive loss properties are subject to the elimination of subsidies once FEMA develops guidance for their removal.

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[27] Homeowner Flood Insurance Affordability Act of 2014, H.R. 3370, 113th Cong. (2014) (Pub. L. No. 113-89).
[28] FEMA, *Homeowner Flood Insurance Affordability Act Overview*, https://www.fema.gov/media-library/assets/documents/93074 (last viewed Mar. 26, 2015).
[29] FN 27, at section 5.
[30] Florida NFIP statistics contained in this and the following paragraphs are from the House Insurance & Banking Subcommittee meeting materials for the September 25, 2013 meeting.
[31] Wharton Center for Risk Management and Decision Processes, Issue Brief, Fall 2011 – "Who's paying and who's benefiting most from flood insurance under the NFIP? A Financial Analysis of the US. National Flood Insurance Program," opim.wharton.upenn.edu/risk/library/WRCib2011b-nfip-who-pays.pdf

Private Market Flood Insurance in Florida

The 2014 Legislature enacted s. 627.715, F.S., governing the sale of personal lines, residential flood insurance.[32] Flood is defined in the standard NFIP policy as a general and temporary condition of partial or complete inundation of two or more acres of normally dry land area or of two or more properties from:

- Overflow of inland or tidal waters;
- Unusual and rapid accumulation or runoff of surface waters from any source;
- Mudflow; or
- Collapse or subsidence of land along the shore of a lake or similar body of water as a result of erosion or undermining caused by waves or currents of water exceeding anticipated cyclical levels that result in a flood as defined above.

Authorized insurers may sell four different types of flood insurance products:

- Standard coverage, which covers only losses from the peril of flood as defined in the bill, which is the definition used by the National Flood Insurance Program (NFIP). The policy must be the same as coverage offered from the NFIP regarding the definition of flood, coverage, deductibles, and loss adjustment.
- Preferred coverage, which includes the same coverage as standard flood insurance and also must cover flood losses caused by water intrusion from outside the structure that are not otherwise covered under the definition of flood in the bill.
- Customized coverage, which is coverage that is broader than standard flood coverage.
- Supplemental coverage, which supplements an NFIP flood policy or a standard or preferred policy from a private market insurer. Supplemental coverage may provide coverage for jewelry, art, deductibles, and additional living expenses. It does not include excess flood coverage over other flood policies.

Insurers must provide prominent notice on the policy declarations or face page of deductibles and any other limitations on flood coverage or policy limits. Insurance agents that receive a flood insurance application must obtain a signed acknowledgement from the applicant stating that the full risk rate for flood insurance may apply to the property if flood insurance is later obtained under the NFIP.

An insurer may establish flood rates through the standard process in s. 627.062, F.S. Alternatively, rates filed before October 1, 2019, may be established through a rate filing with the Office of Insurance Regulation (OIR) that is not required to be reviewed by the OIR before implementation of the rate (“file and use” review) or shortly after implementation of the rate (“use and file” review). Specifically, the flood rate is exempt from the “file and use” and “use and file” requirements of s. 627.062(2)(a), F.S. Such filings are also exempt from the requirement to provide information necessary to evaluate the company and the reasonableness of the rate. The OIR may, however, examine a rate filing at its discretion. To enable the office to conduct such examinations, insurers must maintain actuarial data related to flood coverage for two years after the effective date of the rate change. Upon examination, the OIR will use actuarial techniques and the standards of the rating law to determine if the rate is excessive, inadequate or unfairly discriminatory. The law allows projected flood losses for personal residential property insurance to be a rating factor. Flood losses may be estimated using a model or straight average of models found reliable by the Florida Commission on Hurricane Loss Projection Methodology.

Insurers that write flood coverage must notify the OIR at least 30 days before doing so in this state and file a plan of operation, financial projections, and any such revisions with the OIR. Surplus lines agents may export flood insurance without making a diligent effort to seek coverage from three or more authorized insurers until July 1, 2017. Citizens Property Insurance Corporation is prohibited from providing flood insurance and the Florida Hurricane Catastrophe Fund is prohibited from reimbursing flood losses.

<u>Effect of the Bill</u>

[32] Ch. 2014-80, Laws of Fla.

The bill amends s. 627.715, F.S., to allow insurers to sell flexible flood insurance, which is defined as coverage for the peril of flood that may include water intrusion coverage and differs from standard or preferred coverage by:

- Including a deductible as authorized in s. 627.701, F.S.
- Being adjusted in accordance with s. 627.7011(3), F.S.
- Covering only the principal building, as defined in the policy.
- Including or excluding coverage for additional living expenses.
- Excluding coverage for personal property or contents.

Flexible flood coverage must be acceptable to the mortgage lender if it is intended to satisfy a mortgage requirement.

The section removes language in statute that specifies a supplemental flood insurance policy does not include flood coverage for the purpose of excess coverage over any other insurance policy covering the peril of flood. Removing this language from law could allow a supplemental flood insurance policy to provide coverage in excess of other coverage that is insuring for the peril of flood.

The bill also clarifies the signed acknowledgement that a licensed insurance agent must obtain notifying the applicant about the potential loss of subsidized rates when discontinuing coverage from the NFIP. The notice is revised to specify that the policyholders, who might lose subsidies, are those who have subsidized NFIP policies.

Lastly, the bill allows an insurer to request from the OIR a certification that acknowledges that the insurer provides a policy, contract, or endorsement for the flood insurance that provides coverage equaling or exceeding the flood coverage offered by the NFIP. A certified policy must be in compliance with 42 U.S.C. s. 1042a(b), which requires federally regulated lending institutions to accept private flood insurance that insures the building and personal property securing the loan for the term of the loan in an amount not less than the outstanding principal balance of the loan or the limit of NFIP flood insurance coverage, whichever is less. Subject to the OIR's verification that the policy is NFIP-equivalent, an insurer or its agent may reference or include such certification in advertising and communications with an agent, a lending institution, an insured, and a potential insured. The authorized insurer may also include a statement that notifies an insured of the certification on the declarations page or other policy documentation related to flood coverage. A knowing misrepresentation that a flood insurance policy is certified is an unfair or deceptive act.

B. SECTION DIRECTORY:

Section 1. Amends s. 627.715, F.S., relating to flood insurance.

Section 2. Provides an effective date of July 1, 2015.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

To the extent that the bill encourages more private insurers to provide coverage for flood loss, consumers may ultimately benefit from increased competition.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided by the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES