

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/CS/HB 813 Flood Insurance
SPONSOR(S): Commerce Committee; Insurance & Banking Subcommittee; Lee
TIED BILLS: **IDEN./SIM. BILLS:** CS/CS/SB 420

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	15 Y, 0 N, As CS	Lloyd	Luczynski
2) Commerce Committee	27 Y, 0 N, As CS	Lloyd	Hamon

SUMMARY ANALYSIS

The National Flood Insurance Program (NFIP) is a federal program that offers subsidized flood insurance to property owners and promotes land-use controls in floodplains. Anticipating substantial rate increases in the NFIP, the Legislature created s. 627.715, F.S., in 2014 to provide a framework for a private, personal lines flood insurance market in Florida. This law does not apply to excess flood insurance or commercial lines flood insurance.

Insurers who wish to provide Florida-authorized coverage may develop rates for flood coverage by filing the rate with the Office of Insurance Regulation (OIR) and obtaining approval, or, until October 1, 2019, using a rate without OIR's approval, so long as it meets ratemaking standards. In addition, until July 1, 2017, a surplus lines agent may export a personal lines flood insurance policy without having to determine that coverage is unavailable from an admitted carrier (i.e., obtain three declinations of coverage, which is known as the statutory due diligence requirement).

The Florida Commission on Hurricane Loss Projection Methodology (Commission) is required to adopt actuarial methods, principles, standards, models, or output ranges for personal lines residential flood loss and is required to revise these adoptions each odd-numbered year.

The bill:

- Extends the exemption from statutory due diligence requirement when exporting flood insurance to surplus lines insurers from July 1, 2017, to July 1, 2019, and provides the exemption ends earlier in certain circumstances.
- Upon expiration of the exemption, provides for an exception related to the statutory due diligence requirement if there are less than three admitted flood insurers so that policies can be exported to surplus lines insurers when all admitted insurers decline coverage.
- Adds a financial strength requirement for surplus lines insurers writing flood insurance.
- Creates new requirements applicable to agents placing an NFIP covered property with a Florida flood insurer and removes the obligation to secure a required acknowledgement from an applicant that is leaving the NFIP, if the NFIP removes limitations on former NFIP-insureds returning to the program at a subsidized rate.
- Eliminates an exclusion that held that regulation under Florida's flood insurance statute did not apply to excess flood insurance. This change allows excess flood insurers to make information rate filings and gives them relief from due diligence requirements.
- Changes the frequency of Commission adoptions of flood loss projection guidelines from every odd-numbered year to at least once every four years.
- Corrects a technical error regarding issuance of flexible flood insurance coverage.

The bill has no fiscal impact on state government and an indeterminate, but likely positive, fiscal impact on local government expenditures. The bill may have a positive impact on the private sector.

The bill has an effective date of July 1, 2017.

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 insured almost \$1.29 trillion in assets in 2014 and \$1.27 trillion in assets in 2015. Total earned premium for NFIP coverage for 2014 was \$3.56 billion and for 2015 was \$3.45 billion.²

The Biggert-Waters Flood Insurance Reform Act of 2012

Following flood losses from hurricanes Katrina, Rita, and Wilma in 2005, the NFIP borrowed \$21 billion from the U.S. Treasury in order to remain solvent. However, flood losses in 2012 from Superstorm Sandy increased the NFIP's deficit. In 2012, the United States Congress passed the Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act).³ The Biggert-Waters Act reauthorized the NFIP for five years, until September 2017. 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 (FIRM) 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 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 Biggert-Waters Act also requires most NFIP policyholders to pay a 5 percent assessment on their policy to create a reserve fund for catastrophic losses.⁴ Additional changes to premium rates can occur upon remapping, including those premiums paid by the 80 percent of NFIP policyholders with non-subsidized rates. Rate increases due to remapping have been limited to 10 percent per year, but larger annual rate increases for remapped properties are pending under the Biggert-Waters Act, which were modified by the 2014 federal omnibus spending bill.

¹ FEMA, *National Flood Insurance Program, Program Description*, (Aug. 1, 2002), <https://www.fema.gov/media-library/assets/documents/1150?id=1480> (last visited Mar. 1, 2017).

² FEMA, *Total Coverage by Calendar Year*, <http://www.fema.gov/statistics-calendar-year> (last visited Mar. 1, 2017).

³ FEMA, *National Flood Insurance Program: Laws & Regulations*, <https://www.fema.gov/national-flood-insurance-program-laws-regulations> (last visited Mar. 1, 2017).

⁴ For those NFIP policies with a 25 percent rate increase, the 5 percent assessment is not on top of the 25 percent rate increase. In other words, 5 percentage points of the 25 percent increase will be allocated to the Reserve Fund.

2014 Federal Flood Reform Bills

The Consolidated Appropriations Act of 2014 and the Homeowner Flood Insurance Affordability Act of 2014⁵ repealed or modified some provisions of the Biggert-Waters Act. The new law reduced the mandatory rate increases for subsidized properties from 25 percent annually to no less than 5 percent, generally not to increase more than 18 percent annually.⁶ 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 5 year annual phase-in of premium increases after adoption of a new or updated FIRM was reduced to a maximum of no more than an 18 percent annual premium increase. For property not currently at a full-risk rate, a minimum increase of 5 percent 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 FIRM for the community was adopted.⁷

Private Market Flood Insurance in Florida

In response to the changes to the NFIP, the 2014 Legislature created s. 627.715, F.S., governing the sale of personal lines residential flood insurance.⁸ “Flood” is defined 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.⁹

Under the 2014 law, authorized insurers could sell four different types of flood insurance products:

- Standard coverage, which covers only losses from the peril of flood, as defined, (s. 627.715, F.S., uses the same definition as the 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.
- 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.

In 2015, the Legislature amended the law to add a fifth category – “flexible flood coverage.”¹⁰ Flexible flood coverage is defined as the coverage for the peril of flood that may include water intrusion coverage, and includes or excludes specified provisions, including the authority to limit coverage to only the outstanding mortgage on the property and to allow dwelling loss to be adjusted only on the actual cash value of the property. However, while flexible flood coverage was added to the types of flood insurance described in law, it was not added to the list of types that insurers may issue.¹¹

⁵ Homeowner Flood Insurance Affordability Act of 2014, H.R. 3370, 113th Cong. (2014) (Pub. L. No. 113-89).

⁶ FEMA, *Changes to the National Flood Insurance Program – What to Expect*, available at <https://www.fema.gov/media-library/assets/documents/96449>, (last visited Mar. 1, 2017).

⁷ Homeowner Flood Insurance Affordability Act of 2014, at s. 5, H.R. 3370, 113th Cong. (2014).

⁸ Ch. 2014-80, Laws of Fla.

⁹ s. 627.715(1)(b), F.S.

¹⁰ Ch. 2015-69, Laws of Fla.

¹¹ s. 627.715, F.S.

A flood insurer may establish rates through the standard process in s. 627.062, F.S., i.e., before implementation of the rate (“file and use” review) or shortly after implementation of the rate (“use and file” review). Alternatively, rates filed before October 1, 2019, may be established through an informational rate filing that is not required to be reviewed by OIR. 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.

OIR may 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, 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.

Florida Commission on Hurricane Loss Projection Methodology

In 1995, the Legislature established the Florida Commission on Hurricane Loss Projection Methodology (Commission) to serve as an independent body within the State Board of Administration.¹² The Commission is comprised of 12 members. Members include experts in insurance-finance, statistics, computer system design, structural engineering, and meteorology (each of the preceding members must be full-time faculty members in the State University System), three actuaries, the Executive Director of Citizens Property Insurance Corporation, the senior employee responsible for Florida Hurricane Catastrophe Fund operations, the Insurance Consumer Advocate, and the Director of Emergency Management. The Commission sets standards for hurricane loss projection methodology and examines the methods employed in proprietary hurricane loss models used by private insurers in setting property insurance rates to determine whether they meet the Commission’s standards.

In addition to its efforts concerning hurricane loss projections, the Commission is required to adopt actuarial methods, principles, standards, models, or output ranges for personal lines residential flood loss no later than July 1, 2017. The Commission’s work in this regard is ongoing. Once adoption occurs, it is required to revise actuarial methods, principles, standards, models, or output ranges each odd-numbered year.

Surplus Lines

A surplus lines agent can export a contract or endorsement for flood insurance without the obligation to conduct the due diligence required in law.¹³ Statutory due diligence requires an agent to determine that the insurance is not available from a company currently writing in the state and limits any amount that may be exported to the amount in excess of the amount that can be procured in the state. The agent must document that he or she has made a diligent effort to procure the coverage from an admitted insurer.¹⁴ This is one of five conditions currently applicable to agents who seek to export other lines of insurance. The four others relate to premium, the policy form, deductible amounts, and notice to an applicant of the availability of coverage from Citizens.¹⁵ In general, the conditions prevent a surplus lines insurer, which is subject to substantially less regulation than an admitted insurer, from offering policies with terms and conditions that are more favorable than can be offered by an admitted insurer. This exemption from the statutory due diligence requirement is scheduled for repeal July 1, 2017.

¹² The Commission is created in s. 627.0628, F.S. This statute also provides the composition and duties of the Commission.

¹³ s. 626.916(1)(a), F.S.

¹⁴ Section 626.914, F.S., defines “diligent effort” as seeking and being denied coverage from at least three authorized insurers in the admitted market, unless the cost to replace the property insured is \$1 million or more. In that case, diligent effort is seeking and being denied coverage from at least one authorized insurer in the admitted market.

¹⁵ Current law prohibits Citizens from offering flood coverage. s. 626.916(6), F.S.

Financial Strength Ratings

There are multiple private organizations that engage in the evaluation and rating of insurance companies for the purposes of identifying the financial strength of insurers.¹⁶ These financial strength ratings allow potential investors to make informed decisions regarding possible investment in the rated insurer. The rating companies use similar terminology, but each has a proprietary method to establish their rating results. While the rating results are similar, one should review the rating organization's own explanation of its approach and methods to understand the subtle differences that occur when a particular insurer is rated by multiple rating organizations. A.M. Best's Financial Strength Rating is divided between "Secure," with ratings between A++ and B+, or "Vulnerable," with ratings of B or lower. Among the "Secure" ratings, A++ and A+ are described as "Superior," A and A- are described as "Excellent," and B++ and B+ are described as "Good" in terms of A.M. Best's opinion of the company's ability to meet financial obligations.¹⁷

Effect of the Bill

The bill:

- Corrects a technical error that prevents insurers from issuing "flexible flood insurance."
- Extends the exemption from statutory due diligence when exporting flood insurance to surplus lines insurers from July 1, 2017, to July 1, 2019, but removes this exception earlier if the Office of Insurance Regulation determines that there is an adequate admitted market for flood insurance coverage.
- Upon expiration of the exemption, provides for an exception related to the statutory due diligence requirement if there are less than three admitted flood insurers so that policies can be exported to surplus lines insurers when all admitted insurers decline coverage.
- Limits the exportation of flood insurance unless the surplus lines insurer maintains a financial strength rating of "superior" or "excellent" by A.M. Best Rating Services.
- When handling a change in insurers on a property that is insured under the NFIP, it requires the agent to procure an acknowledgement of the impact of such change from the insured:
 - Within 21 days after the NFIP policy expires, or
 - Within 7 days before the expiration of the timeframe for returning to the NFIP at a subsidized rate.¹⁸

If the acknowledgement is not obtained within the time limitation, the flood insurance must be placed with an NFIP insurer.

- Removes the obligation to secure the required acknowledgement if the NFIP removes limitations on returning to the program at a subsidized rate.
- Authorizes excess flood insurers to choose to make an informational rate filing like other flood insurers and provides excess flood insurers an exemption from the due diligence requirement applicable to exportation of policies to the surplus lines.
 - The bill excludes excess flood insurance from provisions requiring a notice to OIR 30 days prior to writing flood insurance and the filing and updating of a plan of operation and financial projections.
- Changes the frequency of revision of adopted actuarial methods, principles, standards, models, or output ranges for flood loss projections from once every odd-numbered year to at least once every four years.

B. SECTION DIRECTORY:

Section 1. Amends s. 627.0628, F.S., relating to the Florida Commission on Hurricane Loss Projection Methodology; public records exemption; public meetings exemption.

¹⁶ Financial strength rating organizations include: A.M. Best (www.ambest.com), Fitch (www.fitchratings.com), Moody's Investor Services (www.moodys.com), Standard & Poor's (www.standardandpoors.com), and Demotech (www.demotech.com).

¹⁷ See A.M. BEST COMPANY, Guide to Best's Financial Strength Ratings, <http://www.ambest.com/ratings/guide.pdf> (Last visited Feb. 28, 2017).

¹⁸ Currently, there is no time limit on obtaining the required acknowledgement and there is no stated consequence for a failure to obtain it.

Section 2. Amends s. 627.715, F.S., relating to flood insurance.

Section 3. Provides an effective date of July 1, 2017.

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:

Indeterminate. The impact is likely positive to the extent that local governments benefit from increased competition in the flood insurance market.

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. The availability of placing flood insurance coverage in the surplus lines market may increase access to coverage for property owners, but could negatively affect the development of the Florida flood insurance market by creating an uneven 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 action requiring the expenditures of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of 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

On March 7, 2017, the Insurance & Banking Subcommittee considered the bill, adopted one amendment, one amendment to the amendment, and reported the bill favorably with a committee substitute.

The amendment removed changes related to commercial lines residential and commercial lines nonresidential flood insurance to maintain current law and applied the flood insurance law to excess flood insurance, with certain exceptions.

The amendment to the amendment restored the language in the bill, which extends the expiration of the exemption from surplus lines exportation due diligence requirements rather than deleting the exemption, as was proposed in the primary amendment.

On April 19, 2017, the Commerce Committee considered the bill, adopted one amendment, and reported the bill favorably as a committee substitute. The amendment:

- Restored current law that allows the use of informational rate filings until October 1, 2019, rather than extending this until October 1, 2025, as proposed by the bill.
- Extended the expiration date for the exemption from required due diligence when exporting flood insurance to surplus lines insurers to July 1, 2019, rather than July 1, 2025, as proposed by the bill.
 - Removed this exception earlier if the Office of Insurance Regulation determines that there is an adequate admitted market for flood insurance coverage.
- Provided for a lower number of declinations, in specified situations, prior to exporting flood insurance to a surplus lines insurer.
- Revised conditions on a required notice and relieves agents of the notice obligation, if there is a specific change in the National Flood Insurance Program.

The staff analysis has been updated to reflect the committee substitute.