



National Association of
Professional Surplus Lines
Offices, Ltd.

4131 N. Mulberry Dr., Suite 200
Kansas City, MO 64116
816.741.3910

Date: January 6, 2017

Re: Loans In Areas Having Special Flood Hazards – Private Flood Insurance
Docket ID: OCC-2016-0005

To whom it may concern:

The National Association of Professional Surplus Lines Office (NAPSLO) appreciates the efforts of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the National Credit Union Administration (collectively referred to as “the Agencies”) for their work in issuing its proposed regulations on, “Loans in Areas Having Special Flood Hazards – Private Flood Insurance.”

NAPSLO is the professional trade association representing the surplus lines industry and the wholesale insurance distribution system. Comprised of approximately 400 wholesale broker member firms, 100 surplus lines insurance companies, and 200 associates and service providers to the surplus lines market, our membership operates in more than 1,500 offices representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide – all of whom are committed to the wholesale distribution system and U.S. surplus lines market. NAPSLO wholesale broker members are placing an estimated \$35.3 billion in surplus premium and NAPSLO insurance company members are underwriting an estimated \$28.0 billion in surplus lines premium, representing 88% and 70%, respectively, of the U.S. surplus lines market.

The surplus lines market, also known as the nonadmitted market or E&S market, plays an important role in providing insurance for nonstandard and complex risks – including flood insurance. Often called the “safety valve” of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by providing capacity to catastrophe-prone risks and coverage for risks that are declined by the standard underwriting and rating processes of standard/admitted insurance carriers. In 2015, the surplus lines market represented \$41.3 billion in direct written premium, approximately 7% of the entire property and casualty market and over 14% of commercial lines premium.

Definition of Private Flood

The Biggert-Waters Flood Insurance Reform Act of 2012 (BW12), which reauthorized the National Flood Insurance Program (NFIP), sought to expand the ability of private insurance to fulfill the mandatory flood insurance purchase requirement. However, the definition of private flood insurance that was made part of the new law has become very problematic for our industry, lenders and consumers. Although BW12 sought to expand consumer options, it ultimately created uncertainty for lenders regarding the acceptance of private flood insurance



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to fulfill the mandatory purchase requirement. While the proposed regulations on the definition of private flood insurance reflect the Agencies' good effort to implement the statutory language enacted in (BW12), the proposed regulations unfortunately serve to further illustrate the serious and inherent flaws in the original statutory language, which the Agencies appear to recognize in noting their limitations based on what that statutory language requires.

Specifically, the proposed regulations do not appropriately refer to surplus lines insurance with "eligible insurer" and "home state" terminology as adopted in federal law through the Nonadmitted and Reinsurance Reform Act (P.L. 111-203). We understand that, given the underlying BW12 statute with which they are working, this issue is not something the Agencies can fix through administrative action, but we strongly believe it is an important reason for the Agencies to delay implementing regulations at this time.

Fixing this conflicting language, among other reasons discussed below, is why NAPSLO strongly supports the passage of *Flood Insurance Market Parity and Modernization Act*. This legislation will clarify and simplify the definition of "private flood insurance" in a way that addresses many of the challenges that the Agencies note and attempt to address throughout this proposed rule. The bill had significant bipartisan support as evidenced by unanimous votes at both the House Financial Services Committee (53-0, March 2, 2016), which drafted BW12, as well as the full U.S. House of Representatives (419-0, April 28, 2016).

NAPSLO strongly supports the *Flood Insurance Market Parity and Modernization Act* because in addition to correcting language, it further clarifies the definition of private flood insurance to make clear that surplus lines insurers are eligible to offer private market solutions and alternatives to consumers with unique and complex residential and commercial flood risks. Although surplus lines insurance companies are currently allowed to provide private flood insurance, the definition of private flood insurance implemented in the BW12 revisions to provisions in 42 U.S.C.A. §4012a created uncertainty for lenders and consumers. Under BW12, the definition of "private flood insurance" may preclude some insurers that are otherwise permitted to write insurance within the state of the insured. Surplus lines carriers, in particular, are concerned that some lenders and regulators may not understand their eligibility to write insurance within the state of the insured. The *Flood Insurance Market Parity and Modernization Act* fixes the definition of "private flood insurance" to reflect the "eligible insurer" and "home state" terminology as adopted in federal law through the *Nonadmitted and Reinsurance Reform Act* (P.L. 111-203). This is why we believe that adopting these regulations perpetuates the problem with the outdated language of BW12 and it is to the benefit of all to delay adoption of the regulations as Congress considers fixing the definition during the upcoming Congressional session.



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Further, while the proposed regulations offer additional, much-needed clarification as to what constitutes a policy that is, “at least as broad as” an NFIP policy, it would still require lending institutions to make determinations as to the adequacy of an insurance policy that could be open to interpretation. This sort of uncertainty stifles the development of the private flood market, leading us right back where we started despite the intent of Congress and the Agencies to expand private market solutions.

Compliance Aid

NAPSLO strongly supports the state based system of insurance regulation and believes that the authority to regulate insurance companies and insurance markets should remain under the purview of state insurance regulators because of their experience and strong track record of successful regulation in the U.S. The Agencies include a “compliance aid” to address the concern for lenders to be able to rely on state regulators, or others, to provide proof-positive that the policy in question fulfills the obligation – a recurring flaw of the existing statutory language. However, the compliance aid adds additional steps without removing the requirement that lenders make a determination on the individual insurance policy. The alternative – legislation before the House and Senate – would address this issue directly, reinforcing the state-based regulatory structure without adding additional steps to the process that fall outside the traditional manner in which insurance transactions are conducted.

Discretionary Acceptance

The proposed regulation also includes a “discretionary acceptance” provision to allow lending institutions to accept private flood policies that do not fully meet the statutory definition. The Agencies note that, while the statutory language defines what constitutes a private flood insurance policy, it does not *prohibit* a lender from accepting a policy which does not meet that definition. This provision seems to run directly contrary to the inclusion of the compliance aid – requiring insurers to provide an accompanying statement of the legal justification and attestation that the policy in question fulfills the federal statute.

The extent and regularity of how discretionary acceptance and the compliance aid would be applied would undoubtedly result in uneven implementation of the regulations based on the risk-aversion of the lending institution. This in turn would result in consumers being unsure as to their options and recourse.

NAPSLO also has serious concerns over the Agencies’ discussions over the role of surplus lines insurers in residential versus non-residential coverage. Surplus lines insurance is used to cover risks that are difficult to place because they exceed what the standard market is either capable of or willing to underwrite and provides an important option for consumers seeking coverage for unique or hard to place risks, including flood risks for both the residential and non-residential market.



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Personal Lines and Flood Insurance

Personal lines products are not new to the surplus lines market. A.M. Best's composite of U.S. based surplus lines companies indicates the surplus lines market provides commercial and personal lines products of approximately 85% and 15%, respectively. Surplus lines insurance is generally used to cover risks that the standard market is either unable or unwilling to underwrite. Examples of such personal lines risks include coastal properties exposed to catastrophic storms, high value properties, homeowners in need of coverages or limits that differ from those offered in the standard market, etc. States who deal with catastrophic storms have experienced the normal, downward shift in the standard market's appetite for providing coverage in the wake of catastrophic losses. The surplus lines industry has been able to serve as an effective solution in such cases, offering consumer options that may no longer exist in the standard market.

Flood insurance is not new to the surplus lines market. Consumers whose risks have not fit within the terms and limits of the NFIP and whose risks have been declined by the standard market have leveraged the surplus lines market for many years. Based on data from six of the 14 states with surplus lines stamping offices (California, Florida, Mississippi, Nevada, New York and Texas), the surplus lines market generated flood insurance premium of \$126.6 million in 2014, \$9.9 million of which was for primary residential flood insurance coverage and \$23.7 million of which was for excess residential flood coverage. While these figures represent a very small proportion of the \$40.2 billion surplus lines market and the \$3.6 billion of premium written by the NFIP, they represent solutions for consumers who (1) need higher limits than the \$250,000 residential, \$100,000 personal contents and \$500,000 commercial limits offered by the NFIP; (2) need enhanced coverage from that offered by the NFIP such as replacement costs of the damaged property rather than actual cash value of the property, additional sublimits, additional structures, or the ability to schedule multiple properties on one policy; and/or (3) need additional coverage such as additional living expense, basements, or business interruption for commercial entities.

Further, the surplus lines industry generally serves as the innovator for new and emerging risks and related insurance products. A strength of the surplus lines industry is its ability and flexibility to customize coverage for new and emerging risks that the standard market is either unable or unwilling to underwrite. Surplus lines insurers do this by focusing on underwriting for the specific risk to be insured. In order to ensure new or unique risks are underwritten appropriately, surplus lines insurers are highly specialized and conduct specific research to understand the underlying exposure. As loss histories develop on these product lines, the standard market will leverage the data and experience from the surplus lines market to develop more standardized products, rates and forms that offer similar solutions. If the Agencies are focused on pursuing the congressionally-stated goal of BW12 to "increase the role of private markets in the management of flood insurance risk," then the Agencies need to replicate, to the



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best degree possible, the manner in which traditional insurance products are offered and secured.

Again, NAPSLO believes this issue would best be addressed through enactment of the *Flood Insurance Market Parity and Modernization Act* as it would simplify the acceptance of private flood insurance with all policies receiving the same consideration.

Conclusion

In closing, NAPSLO thanks the Agencies for their work in trying to implement the definition of private flood insurance. While we believe that the latest regulations make progress on the Agencies' earlier attempt, significant issues continue to exist that make these regulations unworkable. With the Congress set to consider a reauthorization of the National Flood Insurance Program prior to its expiration in 2017, we would encourage the Agencies to delay implementation of these regulations and allow Congress to clarify its intent on this question. It is clear that Congress has envisioned an increasing role for the private market in offering alternatives to NFIP policies and implementing these regulations as currently crafted will delay the development of that market.

Sincerely,

A handwritten signature in blue ink that reads "Brady R. Kelley". The signature is written in a cursive, slightly slanted style.

Brady Kelley
Executive Director

A handwritten signature in blue ink that reads "Keri A. Kish". The signature is written in a cursive, slightly slanted style.

Keri Kish
Director of Government Relations