



A State Approach to Flood Insurance Reform in Florida

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With various provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 taking effect this year, there is growing concern that scheduled rate increases by the National Flood Insurance Program (NFIP) will have adverse effects on hundreds of thousands of Floridians who must carry flood coverage. Elected officials at the local, state and federal levels already have called for a delay in the implementation of the rate increases, and the Florida Cabinet and Legislature have both convened hearings and workshops to discuss the reforms, their potential effects, and what, if anything the state could do to temper the law's negative impacts.ⁱ

The reforms going into effect will exempt the overwhelming majority of primary homeowners in the program, since 80 percent of policyholders already pay a full, unsubsidized premium nationally; in Florida, roughly 87 percent pay full premium.ⁱⁱ

The remaining 13 percent of Florida NFIP customers—roughly 268,500 policiesⁱⁱⁱ—pay subsidized rates and are subject to the rating changes called for under the law. Those who have already seen some rate increases—50,500 policies, or just over 18 percent^{iv}—are second homes or "repetitive loss" properties that taxpayers have already rebuilt more than once.

As high rates are phased-in for more people, some homeowners of modest means may indeed find it difficult to pay their premiums. Additionally, there is concern that Florida's real estate market recovery may be impacted by the law's provision that eliminates subsidized NFIP rates on homes once they are sold, which may incentivize homeowners to "lock" themselves into their properties.^v

These are all valid concerns that have prompted calls for changes or delay to the reforms. However, the best solution to this problem is to offer consumers more choices, rather than halting changes to the program, which most agree are necessary.

As Florida lawmakers work to find solutions to alleviate the impact on NFIP reforms, they should take the following principles into consideration:

1. No proposal should foist additional catastrophe risk onto the state's taxpayers.

Currently, Florida residents are saddled with billions of dollars of hurricane risk primarily through two state agencies: Citizens Property Insurance Corp. and the Florida Hurricane Catastrophe Fund. If either one of these entities runs out of resources to cover its claims after an active hurricane season, they each have the unilateral legal authority to issue bonds and gradually pay off those bonds by levying "assessments" (special hurricane taxes) on virtually every property and casualty insurance policy issued in the state. These taxes could increase the cost of homeowners, auto, renters and commercial insurance on Floridians for several years, during which more storms could strike, compounding the situation.

As such, Florida taxpayers should not be encumbered with the possibility of covering any more risk, especially risk that does not necessarily belong to them. Ultimately, those who live in harm's way—be it hurricanes or floods—should cover their own risk and not expect others to foot the bill. Therefore, any proposal the state examines should first and foremost require it to be actuarially sound and self-sustaining.

2. No proposal should increase state government's role in insurance.

Any proposal that calls for the creation of a "state flood pool" or "fund," or the expansion of any existing state-run insurance entity to cover flood should be rejected even if it is crafted to be "self-sufficient."

Florida has a well-documented history of conceiving state-run insurance programs that are initially well-intentioned and seemingly well-designed, but are eventually corrupted by the infusion of politics. Such was the case with Citizens, which was initially designed to be the insurer-of-last-resort for Floridians genuinely unable to find coverage for their properties in the private market. Its pricing structure was such that it discouraged residents from obtaining its coverage, so that more risk remained with private companies rather than state taxpayers.

But with the election of populist Gov. Charlie Crist in 2006, Citizens was transformed from an insurer-of-last-resort to an active competitor in the insurance market, with an unfair pricing advantage due to its rates being artificially reduced and frozen. These reductions were based not on actuarial math or market forces, but on what politicians arbitrarily considered "fair" at the time. The result, one lawmakers still grapple with, is that Citizens exploded in size to become

the largest property insurer in the state and an underfunded behemoth foisting billions of dollars in hurricane risk onto the state's taxpayers.

As such, lawmakers should avoid the temptation to form or expand a state fund for the purpose of offering flood insurance or covering flood risk. Even if it is designed to be self-sufficient with the proper safeguards, including requiring back-up risk transfer (i.e., private reinsurance) and ensuring that coverage is sold at actuarially sound rates, there is no guarantee it will stay that way. A future short-sighted legislature or irresponsible administration wanting to score political points can easily politicize and corrupt it to something that could impose additional enormous liabilities on the State of Florida. It has happened before, and it can happen again.

3. No proposal should stifle competition; it should expand it.

Capital follows opportunity. As such, the situation this issue has created in Florida may very well be a unique opportunity to attract insurance carriers and their capital to expand their business in the state. This is especially true since most flood insurance coverage in the rest of the world is provided by the private market.

However, according to FEMA, which runs the National Flood Insurance Program, the private sector's key challenge to offer flood coverage is rate and form regulation.^{vi} Therefore, lawmakers should explore ways to establish a regulatory environment where private companies might consider offering flood coverage in Florida as an alternative to the NFIP by lifting the barriers to private sector innovation, which should include streamlining rate and form regulation. Ultimately, insurance is at its most affordable when risk is spread among more companies who compete with each other for business.

However, this must be done in a way that protects consumers (as well as taxpayers, as described in Principle #1). For example, in addition to exploring ways to attract standard, primary insurers to offer flood coverage, lawmakers might also consider ways to open the state's surplus lines carriers to do the same.

Surplus lines is a category of insurance for which there is no market available through standard insurance companies in the regulated, admitted market. Some risks may simply be too large, unusual or complex for standard insurance companies to cover; in these cases, surplus lines brokers can procure a policy specially designed for such risks.

Surplus lines carriers receive less strict regulation from the state, including in regards to rate, but they are nevertheless required to maintain a certain amount of surplus to conduct business in Florida.^{vii} So, although they are not admitted carriers subject to the same degree of regulation from the Office of Insurance Regulation, the Legislature should not overlook them as a viable alternative to the NFIP for flood coverage if there is consumer demand. Indeed, surplus lines

carriers that choose to offer such coverage can and should be subject to additional criteria to protect the consumers they wish to transact business with.

Conclusion

Quite simply, the NFIP cannot continue without the reforms contained in the Biggert-Waters Act. Indeed, the program already owes the Treasury more than \$25 billion that it has no practical way of paying back, so without these reforms, it simply will not be able to go on providing coverage to the 5.6 million Americans and thousands of communities that depend on it.

Even though most primary homeowners now in the program will be exempt by the rate increases, there are actions Florida lawmakers can take to offer additional options, not just to those most affected, but to everyone who needs or desires flood insurance coverage in Florida. These should include lasting, free-market, viable solutions that will not saddle Floridians with enormous liability, bigger government or the potential for massive taxes or bailouts.

Indeed, there are other ideas congress might pursue at the federal level, such as a proposal by Representative Dennis Ross (R-FL) to allow tax credits to retrofit and mitigate properties against catastrophes, which would help reduce the overall cost of insurance.

However, Florida does not have to wait for the feds to act. It has the opportunity to become the nation's model for private sector flood insurance innovation, where the NFIP could go from being the sole flood insurance provider to one of many carriers offering flood. Or perhaps, even, the flood insurer-of-last-resort.

ⁱ Bill Cotterell, "Scott, Bondi, Atwater blast federal flood inaction," *The Florida Current*, Oct. 10, 2013.
<http://www.thefloridacurrent.com/article.cfm?id=34822419>

ⁱⁱ Presentation by Rebecca Matthews, Government Relations Director, Office of Insurance Regulation. Florida Senate Banking & Insurance Committee Meeting, Oct. 8, 2013.

ⁱⁱⁱ Ibid.

^{iv} Ibid.

^v Presentation by Dean Asher, President, Florida Realtors. Florida Cabinet Meeting, Sept. 24, 2013.

^{vi} Presentation by Locke Burt, CEO, Security First Insurance Company. Florida Senate Banking & Insurance Committee Meeting, Oct. 8, 2013.

^{vii} S. 626.58, F.S.