



STATEMENT

OF

**FRANKLIN NUTTER
PRESIDENT
REINSURANCE ASSOCIATION OF AMERICA**

**BRADLEY KADING
PRESIDENT AND EXECUTIVE DIRECTOR
ASSOCIATION OF BERMUDA INSURERS AND REINSURERS**

**CONSIDERATIONS FOR PRIVATIZING THE NATIONAL
FLOOD INSURANCE PROGRAM**

FEMA/NFIP REFORM MEETING

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My name is Frank Nutter and I am president of the Reinsurance Association of America (RAA). The RAA is a national trade association of property and casualty reinsurers doing business in the U.S. Its membership is diverse, and includes reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross-border basis. I am joined by Bradley Kading, president of the Association of Bermuda Insurers and Reinsurers (ABIR). ABIR represents 22 (re)insurers with principal underwriting operations in Bermuda. These companies write about 40% of the property catastrophe reinsurance sold to US ceding insurers; and collectively they have paid nearly \$30 billion in US catastrophe claims this decade. It is a pleasure to speak with you today about the possibility of privatizing the National Flood Insurance Program.

The National Flood Insurance Program (NFIP) supports the built environment and rebuilding in areas at high risk to flooding. But it does so at premium rates that do not reflect predictable economic loss—including catastrophic loss. As a result, the NFIP operates with a built-in deficit that exposes taxpayers to unnecessary costs. Additionally, an unintended consequence of the NFIP is to encourage development in areas that serve as a natural buffer protecting people and property; increasing both flood and storm surge risk, resulting in a loss of natural habitat. Lastly, the NFIP assesses risk without regard to the best scientific forecasts of future trends in weather, climate and other environmental scenarios.

Role of Government

State, local and federal governments play an important and continuing leadership role in land use planning, designing and overseeing building codes, emergency response and promoting community resilience. With regard to flood risk, the most significant of these is to identify and map flood plains and manage development in those flood plains. At the state level, government must remain vigilant in implementing and enforcing local and state building codes with due consideration for extreme weather events—including flood.

Local governments have the best knowledge of development in their areas and a desire for resources from state and federal governments that can help them protect their constituents.

At the federal level, incentives should be provided to state and local government for implementing and enforcing building codes that reduce flood hazard. Furthermore, we encourage national building standards and local land use decisions that are consistent with federal and state protections for natural habitat (e.g. Coastal Barriers Resources Act). It may be appropriate to tie federal disaster assistance to effective community mitigation and forward-looking community disaster preparedness and planning – including pre-determinations regarding flood plain redevelopment.

Protect Taxpayers

As it currently operates, the NFIP is not an insurance program—but it should be. A guiding principle of the NFIP should be to protect taxpayers. One of the ways to achieve that is to privatize the NFIP in whole or in part. In this regard, the private reinsurers and capital markets have the capacity and interest in underwriting flood insurance risk. As is the case with private insurers, managing risk and protecting the financial integrity of an insurance program should be a key design element of the NFIP.

The Government Accountability Office (GAO) states, “Private insurers typically retain only part of the risk that they accept from policyholders, ceding a portion of the risk to reinsurers (insurance for insurers). This mechanism is particularly important in the case of insurance for catastrophic events, because the availability of reinsurance allows an insurer to limit the possibility that it will experience losses beyond its ability to pay. NFIP’s lack of reinsurance, combined with the lack of structure to build a capital surplus, transfers much of the financial risk of flooding to Treasury and ultimately the taxpayer.”

Private insurers and reinsurers as professional underwriters have many leading edge risk modeling, management and engineering tools and expertise that could be applied to the NFIP and the underwriting of flood risk. Private (re)insurance markets have risk financing and risk

transfer capabilities to spread the flood risk into broad based capital markets. Given the challenge that the program has had in achieving full market penetration, better use could be made of the insurers' marketing networks to broaden the policyholder base.

Privatize Flood insurance

Under certain conditions, the private (re)insurance sector could assume the flood risk over time and eliminate or greatly reduce the federal role for providing insurance coverage. An essential element of achieving that goal is that premiums for any continuing NFIP should be set at true risk rates based on sound underwriting including credible mapping, taking into consideration potential catastrophic loss. As with many state residual market insurance programs, incentives for insurers to assume NFIP policies should be considered. In order to achieve a better spread of risk and diversify the flood risk, mandatory purchase requirements under federal law should be continued. Vacation, investment and properties not used as a principal residence should not be eligible for federal flood insurance under the NFIP, but should be directed to the private market.

Insurers could be encouraged to underwrite flood policies as part of standard homeowners' policies if allowed to charge actuarially sound, risk-based rates that reflect the cost of capital needed for catastrophic risk. When federal flood coverage is written in the private sector, premiums should be determined by private insurance underwriters and filed with federal authorities and, like the current NFIP, be exempt from state rate regulation. Alternatively, federal law should authorize competitive use and file rating rules for federally-determined flood risk coverage. Another option that should be considered is embedded in the original federal statute: a consortium of private sector underwriters supported by private reinsurance. Another idea might be to utilize the NFIP as an aggregator of risk (at risk-based rates) with a defined strategy to spread the risk to the private reinsurance and capital markets.

We are committed to explore these and other ideas to enable private sector participation.

Federal Subsidies Should Be Eliminated and Community Actions Encouraged

Where they exist in the current NFIP, federal subsidies should be eliminated. Low income homeowners and/or individuals with financial need in designated flood prone areas should be provided with assistance (e.g. vouchers, tax credits), but outside the rate making process. Subsidized rates for properties grandfathered under the current NFIP should be eliminated upon the legal transfer of the property.

Communities that actively seek to mitigate flood risk should be recognized. Premiums should reflect community actions that mitigate flood risk and a community rating system should be followed.

Repetitive loss properties should be rated as such and coverage eliminated at some point after multiple losses; or excluded from the program based on property value. Alternatively, repetitive loss properties should be moved or purchased through federal appropriations.

The National Flood Insurance Program is built on the fundamentally sound principles of encouraging hazard mitigation and promoting the use of insurance to reduce post-event disaster assistance. However, the NFIP as it has evolved and been modified by legislative action is not financially sound and compromises, rather than embraces, sound public policy and insurance principles and practices. Actions to privatize the NFIP, in whole or in part, and retaining the proper role for government, could address those issues and re-establish the flood risk management program as a successful public private partnership.