TESTIMONY OF MARK DAVEY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
FIDELITY NATIONAL INSURANCE COMPANY
ON BEHALF OF THE
WRITE-YOUR-OWN FLOOD INSURANCE COALITION

"THE NATIONAL FLOOD INSURANCE REFORM AND MODERNIZATION ACT OF 2010"
AND
H.R. 1264, "THE MULTIPLE PERIL INSURANCE ACT OF 2009"

FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES
APRIL 21, 2010

My name is Mark Davey and I am President and Chief Executive Officer of Fidelity National Insurance Company. We recognize and share your concerns regarding the National Flood Insurance Program (NFIP) and natural catastrophe issues and we are here today to offer solutions to protect consumers.

Fidelity National is a "Write-Your-Own" (WYO) flood insurance partner with the NFIP and the largest writer, through this Program, of flood insurance in the nation. Fidelity National is also a member of the WYO Flood Insurance Coalition, a group that includes the 85 private insurers that participate in this Program and the national property/casualty trade associations. Thank you for the opportunity to appear before you today on behalf of Fidelity National and the WYO Flood Insurance Coalition.

Introduction

The NFIP has experienced five short-term extensions in just the past few months leading up to this hearing – including two "lapses" when the Program was essentially unable to write new business and provide vital coverage to homes and businesses. These developments have hindered numerous consumer housing closings and caused significant market uncertainty for our nation's 5.5 million NFIP policyholders, real-estate professionals and lenders. Fidelity National and the other 84 "Write-Your-Own" insurers are also very concerned about these short-term extensions and the uncertainty surrounding the future of this vital program.

With respect to the Multiple Peril Insurance Act, unlike the NFIP and some other sectors of the financial services industry, homeowners insurers are sound, stable and able to provide wind coverage where government does not displace markets. Global reinsurance capacity has increased, even after the recent financial crisis, and the homeowners insurance industry has continued to be very strong and stable, with low leveraging and high liquidity to maintain our ability to provide wind coverage without pause during these volatile economic times. Where government maintains regulatory stability and allows insurers to compete like other industries with market-based rates, the private markets are highly effective, efficient, and able to fulfill consumer needs.

Expansion of the NFIP to include wind and any other natural catastrophe insurance issue will ultimately drive out private sector capital and competition, leaving taxpayers with massive risk exposures. To the extent that there are political imperatives to address very specific constituent groups with very specific needs, we believe that discrete and narrowly targeted, market-based solutions should be used rather than a large scale government expansion of the NFIP.

National Flood Insurance Program Reauthorization/Reforms

Insurers like Fidelity National seek a long-term reauthorization of the NFIP to protect consumers and help increase stability for real estate professionals and lenders. We believe that a long-term commitment from Congress will provide WYO insurers with the certainty they need to allocate precious resources to continue a long-term relationship with the NFIP to help administer the Program and provide vital flood protection to our nation. Currently, Congress has entered into a cycle of enacting a series of short-term extensions for the NFIP which has already led to two lapses in the Program's coverage in 2010. WYO insurers and the industry are concerned with the constant short-term extensions and the negative impact it is having on consumers and taxpayers.

Floods are the most common natural disasters to occur in the United States and the NFIP provides over 5.5 million Americans with needed flood insurance coverage. Property damage caused by a flood is not covered under typical personal and commercial property policies. Flood insurance must be bought as a separate policy through the NFIP, which is the primary source for flood insurance in the country.

This year's heavy spring storms serve as yet another reminder that all Americans, not just those in coastal states, need the protection provided by the NFIP. There are NFIP policies in place in every state. In 2008, the average NFIP flood claim was $42,000 per homeowner, with over $2.5 billion in flood damages paid to consumers through the Program. This August will be the fifth anniversary of Hurricane Katrina, and in 2005 flood loss payments from hurricanes Katrina, Rita and Wilma totaled $17.6 billion – the highest amount on record. It is important that we learn from the past to prepare for the future.

Government insurance programs are rarely actuarially sound despite the best intentions of Congress. In fact, the NFIP was created in 1968 in part based on a report by HUD that indicated even if the private insurance industry were to have offered flood insurance on a sound actuarial basis, inhabitants of flood prone areas would have rejected unsubsidized coverage as too costly or too uneconomical. Following the severe 2004 and 2005 hurricane seasons, the NFIP remains heavily in debt. Saddled with almost $1 billion in interest payments on an $18.2 billion loan, it is unlikely that the Program will ever be able to pay off its "credit card." Political pressures will probably prevent the Program from ever achieving market-comparable premium rates or accumulating a safety-net surplus as is required of private insurers.

Regretfully, we do not believe that the Program can recover unless this massive debt is forgiven. In conjunction with forgiving the debt, significant reforms are critical. Once the debt is forgiven, the Program could then "start over" with reforms in place that would put the NFIP back on stronger financial footing. In order to accomplish this goal, the NFIP must ensure that premiums for flood coverage reflect the true costs to taxpayers so that expensive government flood loss subsidies can be eliminated over time.

Insurers participating in the WYO program are responsible for helping administer 95 percent of the NFIP business. Unfortunately, despite continued expensive education and outreach efforts by WYO companies, the number of homeowners and businesses purchasing flood insurance protection has already dropped following its peak after the severe 2004 and 2005 hurricane seasons. Participation in the Program needs to continue to grow. Consumers need to be educated about the importance of having flood insurance and encouraged to continue purchasing it.

Through the partnership established by the WYO program, our company, Fidelity National, is a leading provider of flood insurance. Administering and marketing the flood program is very complex and expensive, and the number of insurers willing to do so under the current federal compensation formula has significantly declined. As fewer private companies have been willing to market the product, it is not surprising that fewer consumers have purchased the product. Unfortunately, this cycle may lead to additional adverse selection and could necessitate further "borrowing" and significant taxpayer exposure through federal aid following a major catastrophe.

There have been recent discussions regarding possible privatization of flood insurance. Industry risk-bearing and pooling was attempted in the 1970s. It was heavily subsidized by the federal government and insurer participation dwindled to the point that the federal government took the risk back. In the 1980s, the WYO program was established to increase consumer purchases of the product. Private insurers set premiums and spread risk amongst all those exposed to loss, not just the ones most likely to incur a loss. Even with a federal program, the vast majority of those who purchase flood insurance do so only because it is required by their mortgage lenders and the likelihood of loss is significant. And political pressures make it extremely unlikely that long-term rate and underwriting freedom would ever be allowed sufficiently to compete for private capital. Before revisiting the privatization issue, we would encourage Congress to take a long, hard look at how such a program would work.

Our industry is also concerned with the lack of exclusive federal jurisdiction over the Program and we continue to encourage Congress to make sure that any and all issues related to the sales and administration of this Program fall under the federal law. The NFIP is overly complex and a consistent interpretation of legal issues through the federal judicial system is necessary. Establishing exclusive federal jurisdiction over all aspects of this Program would also help control litigation costs, which are borne by the NFIP, thus leading to more stable flood insurance premiums.

While the private sector does not currently bear the costs of government subsidies to flood plain consumers, Fidelity National and other WYO insurers believe as a matter of public policy that reforms are needed and that subsidies should be phased out and premiums should be risk-based and reflect additional taxpayer costs. With over $1.2 trillion of insurance exposure in force at the end of 2009, the NFIP needs to have adequate premiums to reflect not only typical year costs, but also potential catastrophic losses, i.e., the probable maximum loss (PML), and capital costs.

Additionally, following the passage of the Flood Insurance Reform Act (FIRA) in 2004, significant improvements were made by the NFIP to its claims appeals process that makes provisions establishing a NFIP ombudsman duplicative and unnecessary. Changes in the maximum amount of coverage available should also be reconsidered as they have not been indexed or adjusted since 1994. And lastly, the mandatory purchase requirement should be strengthened to ensure that those who need the product actually purchase it, hence minimizing the potential taxpayer impact when the next event occurs.

Multiple-Peril Coverage – H.R. 1264

Some have suggested that the NFIP, which already suffers under crushing debt and falls well short of actuarially sound flood underwriting and premium rates, should be expanded to cover windstorm risks. Along with numerous environmental, consumer, budget, and other non-insurance associations, the WYO Flood Insurance Coalition opposes expanding the Program and believes that there are alternative approaches to address problems associated with windstorm coverage. Our industry supports more narrowly targeted legislative and regulatory solutions that address specific problems and concerns without a vast and unnecessary expansion of a government program that is already in debt and in need of return to financial stability.

Impact on the Economy and Affordability of Coverage

Adding wind coverage to the NFIP could have the following consequences:

- According to a study done by Tillinghast, Towers Perrin, if only 20 percent of the property marketplace purchases the NFIP multiple-peril (flood and windstorm) policy, potential losses could total from just over $4 billion to $78 billion, depending on the size and location of a catastrophic event.
- According to a Property Casualty Insurers Association of America (PCI) analysis, federal control of wind insurance policies would result in about 41,775 jobs being eliminated throughout the country. This reduction in workforce translates into $2.6 billion in lost wages that would be removed from the economy.
- Such a program could also mean a loss of more than $26.9 billion in private industry insurance premiums. Insurers must invest premiums to build capital and surplus to cover insured losses. Further, since insurers are strong investors in municipal, state and local bonds, this loss of revenue could result in a loss of more than $20.48 billion in bond investments.

- The loss of revenue from such a market displacement would further result in more than $810 million in lost state premium tax revenue and more than $780 million in individual state and federal income tax revenues.
- Irreparable damage to the private coastal insurance market would also result from such a program being put in place. Small or start-up companies, particularly in Florida and Louisiana, that voluntarily assume policies from the state-run insurance plans, would be put out of business. In Florida alone these companies account for over 28 percent of the property insurance market and $1.9 billion in premiums.
- Instead of spreading risk globally through private reinsurance, risk would be transferred to a smaller region of U.S. taxpayers, and the private reinsurance capital base would subsequently decline affecting other insurance markets across the country.

While constituents may state that they cannot get wind coverage, they may mean that they could not find wind coverage at a price that they want to pay. This has been the experience of the state government-run earthquake insurance program in California (the California Earthquake Authority) where take-up rates hover around 15 percent. Excessive government involvement in a private sector industry may shift costs from pre-funded private capital to post-funded taxpayer capital (which as we are seeing now with the NFIP is a cost-hiding, not a cost-savings), but it results in numerous indirect costs including loss of tax revenue, greater political interference in rate setting, and private job losses.

Here the government has two choices: (1) take over the wind insurance market, which could artificially lower the price of coverage for some, with the potential for enormous costs to all taxpayers, significant damage to the private sector, and a massive cross-subsidy from Americans who do not live in coastal zones; or (2) leave wind coverage to the private and state markets and consider more narrowly targeted solutions, including providing subsidies to individuals who truly cannot afford the risk-based costs of insurance.

Fidelity National and the WYO Flood Insurance Coalition strongly support the latter option. Given the current economic climate, the timing could not be worse to eliminate private investment in the insurance market and to destroy private sector jobs. Instead, Congress could consider giving the small percentage of low-income coastal citizens who truly cannot afford their wind insurance premiums a subsidy that would be phased out over time. Such subsidies should be transparent and outside of the insurance system, so risk-based pricing is not distorted. Destroying the current system would essentially give the entire coastal community a taxpayer subsidy.

Availability

There is sometimes a misperception that windstorm coverage is not available in coastal areas. In fact, every homeowner can find windstorm coverage either through the private market or a state residual market plan. Every large coastal state has a residual market mechanism in place to assure the availability of windstorm coverage, and coverage is available through these entities to more than 99 percent of the properties along the coasts. Only properties in significant disrepair are uninsurable through these programs. The following describes existing state residual market mechanisms:

1. A Fair Access to Insurance Requirements (FAIR) Plan (a program also established by federal law in 1968) has been enacted in California, Connecticut, Delaware, the District of Columbia, Georgia, Hawaii, Maryland, Massachusetts, Mississippi, New Jersey, New York, North Carolina, Oregon, Rhode Island, Texas, Virginia, and Washington.
2. A "windstorm" or "beach" program designed specifically to provide windstorm coverage has been established in Alabama, Mississippi, North Carolina, South Carolina, and Texas.
3. Both Florida and Louisiana have a Citizens Property Insurance Corporation (combination windstorm and FAIR Plan entity).

Wind vs. Water

Proponents of H.R. 1264 have stated that adding wind coverage to the NFIP will eliminate policyholder concerns over whether or not, or how, their claims will be covered under the NFIP and their separate windstorm coverage. In fact, the bill would still require a determination of cause of loss (since the wind and flood perils are separate, with separate premiums). Further, private insurers may write "excess" windstorm coverage (or perhaps excess flood coverage) and determining the appropriate relationship between the amounts covered by each peril may determine how much is paid under this scenario as well.

GAO Report

The GAO issued a report (GAO-08-504) in April 2008 that looked specifically at the issue of expanding the NFIP to include windstorm coverage. The report states that expanding the NFIP would require FEMA to address a number of significant challenges including: (1) determining wind hazard prevention standards; (2) adapting existing programs to accommodate the risk; (3) creating new rate-setting processes; (4) promoting the new program; and (5) staffing and administering the program.

The report also states that even if all these issues were addressed there would still be significant obstacles in establishing such a program. It concludes that "an unknown portion of exposure currently held by state wind programs – nearly $600 billion in 2007 – could be transferred to the federal government." It also indicates that the program would have trouble setting appropriate rates; therefore "the potential exists for losses to greatly exceed expectations…which could further increase FEMA's debt."

Summary of the Perils of Expanding the NFIP

The WYO Flood Insurance Coalition believes that expansion of the NFIP to include a multiple-peril policy to provide coverage for both flood and windstorm loss is ill-advised and would:

- Significantly displace the private market that continues to provide the majority of the windstorm coverage in coastal states, and all of the wind coverage in inland states;
- Disrupt the various long-standing state residual market mechanisms established for the purpose of providing such protection in these catastrophe-prone areas;
- Ultimately be inadequately priced, leading to a further government subsidy of a product widely available in the private marketplace; and
- Create a significant burden on U.S. taxpayers.

Although we recognize that NFIP expansion proposals are prompted by perceived problems in settling claims as between flood and windstorm coverage, current private and federal insurance contracts clearly include three avenues for appeal for consumers who are dissatisfied with their claim settlement. Consumers may: (1) request an appraisal; (2) file an appeal with the NFIP; or, (3) as a last resort, turn to the court system.

For these reasons, Fidelity and the WYO Flood Insurance Coalition urge you not to expand the NFIP to include a multiple-peril policy program in the NFIP reform/reauthorization legislation.

Conclusion

On behalf of Fidelity National and the WYO Flood Insurance Coalition, thank you for the opportunity to present our views today. We look forward to working with you to protect consumers and reform and improve the National Flood Insurance Program.