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Education Library » Private Flood Insurance

Private Flood Insurance

The ink was hardly dry on the President's signature of The Biggert-Waters Flood Insurance Reform Act of 2012 (BW12) when a flurry of private companies started to announce that they suddenly had an appetite for private flood insurance. That, in turn, led to a flurry of emails and phone calls to FAIA asking, "What's your take on this company?"

The issue of private flood insurance is a bit more complex than it appears on the surface. For starters, it's key to understand that "private flood insurance" means that a company is writing flood insurance "on their paper." By that, we mean that the private company is not writing flood insurance as part of the National Flood Insurance Program's "Write Your Own" (WYO) program. Private companies such as Old Dominion, Wright Flood, and American Bankers participate in the WYO program but this is not "private flood insurance." Carriers including Chubb, WNC First, and Lloyd's, have written flood insurance outside of the WYO program for years; now more carriers seem to be jumping into the private flood market. The "sales pitch" is typically that many people are going to be paying a lot more for flood insurance due to the BW12 changes and the private market product is less expensive than the NFIP policy. As with any new product that the agency is considering selling, caution and due diligence are in order.

Start with the agency agreement that is generally required between the agency and company. It's critical that all proposed agency agreements be carefully reviewed for the specific terms and conditions. This is not unique to flood insurance either; it's a principle to be followed in all agency agreements. Usually, the agency should seek legal counsel prior to signing an agency agreement.

The next stop, and perhaps the most critical task, is the policy. Despite what the media and Internet may say, all insurance is not created equal. Insurance is not a commodity and there can be drastic differences between policies with the same name. It's no more correct to say, "All flood policies are the same" than is it to say, "All BBQ is the same." Both statements stray far from reality! Agencies should (and must) take time to read the flood policy of a private carrier and perform a line-by-line of analysis of the coverage forms in order to compare it to the NFIP policy. Careful analysis of the policies being sold by the agency needs to be the cardinal rule of every agency.

With private flood insurance, there is a possible roadblock when compared to the NFIP policy, and that is **the lender**. It has long been the case that some lenders have taken the position of, "We only accept NFIP coverage and will not accept a private policy." The reason is that lenders are "under the gun" by their regulators, such as the FDIC, when it comes to providing evidence of proper flood coverage on loans they have for structures inside a Special Flood Hazard Area. Prior to BW12, lenders faced a fine of up to $350 for each loan they had where they could not show evidence of a flood policy meeting the guidelines of the regulator. The penalty of $350 per loan was subject to an annual lender aggregate of $125,000. To a major lender, $125,000 is a small figure so the potential financial penalty was relatively minor. A provision of BW12, however, significantly changes the financial risk to a lender by increasing the maximum fine to $2,000 and removing the annual cap. So assume that a lender was found to be non-compliant on 3,000 loans; that turns into a possible $6 million fine for the lender and that is hardly "chump change" to most lenders. The result of this increased fine potential is that lenders must fully understand the guidelines for flood insurance and comply with them or risk severe fines.

Relating to private flood insurance, Section 100239 of BW12 states the following:

"Each Federal agency lender shall accept private flood insurance as satisfaction of the flood insurance coverage requirement under the preceding sentence if the flood insurance coverage provided by such private flood insurance meets the requirements for coverage under such sentence.";

"(7) PRIVATE FLOOD INSURANCE DEFINED.—In this subsection, the term ‘private flood insurance' means an insurance policy that -

"(A) is issued by an insurance company that is-

"(i) licensed, admitted, or otherwise approved to engage in the business of insurance in the State or jurisdiction in which the insured building is located, by the insurance regulator of that State or jurisdiction; or

"(ii) in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, is recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the State or jurisdiction where the property to be insured is located;

"(B) provides flood insurance coverage which is at least as broad as the coverage provided under a standard flood insurance policy under the national flood insurance program, including when considering deductibles, exclusions, and conditions offered by the insurer;

"(C) includes-

"(i) a requirement for the insurer to give 45 days' written notice of cancellation or non-renewal of flood insurance coverage to-

"(I) the insured; and

"(II) the regulated lending institution or Federal agency lender;

"(ii) information about the availability of flood insurance coverage under the national flood insurance program;

"(iii) a mortgage interest clause similar to the clause contained in a standard flood insurance policy under the national flood insurance program; and

"(iv) a provision requiring an insured to file suit not later than 1 year after date of a written denial of all or part of a claim under the policy; and

"(D) contains cancellation provisions that are as restrictive as the provisions contained in a standard flood insurance policy under the national flood insurance program."

Note, in particular, paragraph (B), which states that the private flood policy must be at least as broad as the NFIP policy. This section is a cause of concern for lenders since if they are audited and the regulator determines that the private policy is not at least as broad as NFIP that lender risks substantial fines. That provision has led at least one lender (with many more to come) to send a lender-specific form to the agency after the agency provided the lender with a private flood policy. The form asks the agent to certify that the private flood policy meets the requirements of BW12 by signing the form and returning it to the lender. **Under no circumstances should the agency sign the form**, nor should the agency make any assurances via email, U.S. mail, fax, or verbally. The agency should supply the complete policy to the lender and let the lender review it on their own. It is the lender's financial resources at risk and it is their responsibility to determine if their regulators will be satisfied with a private flood policy. Imagine an agency signing a lender form certifying that a private flood policy is at least as broad as the NFIP policy and a lending regulator determines otherwise. If the lender is fined over this issue it's realistic to expect that the lender might look to the agency for reimbursement.

The phrase "coverage at least as broad" can also be problematic. For example, one carrier that has written private flood insurance for some time provides a policy with many features that "blow the socks off" of the NFIP policy. Some of those features include: a single deductible rather than separate deductibles for building and contents; replacement cost coverage on the structure in all cases, even if the structure is not rebuilt; replacement cost coverage on contents, carpet, and appliances; increased limits for jewelry and antiques; enhanced basement coverage; additional living expense coverage; increased coverage for loss mitigation expenses prior to a loss; ordinance and law coverage. There is, however, a vacancy deductible in the policy stating that if the structure has been substantially empty of contents for more than 30 consecutive days prior to the loss then the deductible is five times the deductible shown on the declarations page. That provision is not found in the NFIP policy, so the question now becomes whether this private policy is at least as broad as NFIP. Does the fact that there is a vacancy deductible override all of the "bells and whistles" in the coverage enhancements? Clearly (in my view, anyway), this private policy offers substantial advantages to the customer with very few policy provisions that would cause hardship to the customer. Is this policy at least as broad as NFIP? To say it again, that is for the lender to determine and the agency can make no assurances that it is.

Proceed with caution on private flood insurance. Review the agency agreement and policy. Don't let a lender force you down the E&O highway.

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(2 ratings)