

Technical Advisory



TA 322

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Subject: Private Flood Insurance

Background: In recent months, several WYO flood insurance companies have announced that they will begin marketing private flood insurance alongside of NFIP flood insurance. Private flood insurance is very different from NFIP flood insurance, which raises a number of issues for insurance agents.

Main Points: NFIP flood insurance is written on three [Standard Flood Insurance Policy Forms](#) and underwritten by the federal government no matter which WYO flood insurance company might issue the policy. NFIP standardization insures agents that they are providing their customers with a stable and consistent way to insure against the peril of flood.

Private flood insurance is not standardized. The coverage provided by the policy and the financial security of the insurance company providing the coverage can vary considerably. This presents insurance agents with the challenge to insure that they are providing customers with appropriate flood insurance coverage.

Following are some of the issues that agents should consider before offering their customer private flood insurance coverage.

Direct Solicitation

Some WYO flood insurance companies have provided flood policy information to third party private flood insurance companies and indicated to agents that they intend to offer alternative private flood insurance quotes with renewals of existing NFIP policies. [Louisiana Revised Statute 22:23](#) prohibits an insurance company from sharing policyholder information with third parties for the purpose of soliciting the customer of an independent agent without the express written consent of the agent. Following is an excerpt from the statute:

Louisiana Revised Statute 22:23

§23. Exclusive use of expirations

A.(1) Except as otherwise provided herein, for purposes of soliciting, selling, or negotiating the renewal or sale of insurance coverage, insurance products, or insurance services, an insurance producer shall have the exclusive use of expirations, records, or other written or electronic information directly related to an insurance application submitted by or an insurance policy written through an insurance producer. No insurance company, managing general agent,

surplus lines insurance broker, wholesale broker, third party administrator, or residual markets including but not limited to the Louisiana Automobile Insurance Plan, the Louisiana Joint Reinsurance Plan, or the Louisiana Insurance Underwriting Plan, shall use such expirations, records, or other written or electronic information to solicit, sell, or negotiate the renewal or sale of insurance coverage, insurance products, or insurance services to the insured, either directly or by providing such information to others without the express written consent of the insurance producer.

In addition to the philosophical importance of protecting the exclusive use of independent agent expirations, these direct solicitations create a practical problem for agents. Insurance companies are going to solicit private flood insurance in zones where the risk of flood is small and the private flood insurance is very price competitive with NFIP. If a customer receives a direct private flood insurance solicitation which is much cheaper than the NFIP renewal, they will most likely choose the private flood alternative without understanding any of the possible concerns outlined below.

Flood insurance should only be placed in a private market after careful consideration and consultation with an experienced insurance agent who can properly advise the customer that the private flood insurance alternative is appropriate. Direct solicitation by the insurer is not only unlawful, but may not be in the best interests of the policyholder. If an agency chooses, they can ask their flood insurance company not to direct solicit their NFIP renewals with private flood insurance proposals as required by [Louisiana Revised Statute 22:23](#).

Conflicts with NFIP Rules

Under current federal law and NFIP rules, certain properties are "grandfathered" with historical base flood elevation requirements and therefore pay substantially lower flood insurance premiums. In order to maintain this "grandfather" status of the property, **NFIP** flood insurance must be maintained on the property without interruption. Private flood insurance does not meet this requirement. If a customer switches coverage from an NFIP policy to a private flood insurance company, they lose their "grandfather" status forever! For some properties, the cost of flood insurance without the "grandfather" status is prohibitive, which could make some properties practically unsellable.

Private flood insurance markets also raise questions about NFIP rules related to the ability to transfer policies, insure repetitive loss properties, ability to rewrite private flood policies back into NFIP, waiting periods, grace periods, qualifications for federal disaster assistance, etc.

Nonstandard Policy Forms & Rates

Most of the private flood insurance markets are written in nonadmitted / surplus lines insurance companies. As a result, the insurance company has freedom of rate and form. This may be beneficial or harmful to the policyholder depending upon the circumstances.

Some private flood insurance coverage forms provide broader coverages than the standard NFIP policy form, which could benefit the policyholder. For example, some private flood insurance policies provide broader replacement cost coverage or additional living expense. However, some private flood insurance policies have coverage limitations which provide less coverage than the standard NFIP policy. For example, certain types of property may not be covered, there may be coinsurance requirements, or a provision which allows the private flood insurance company to cancel the policy in as short as 45 days.

We are already hearing from private flood insurance companies, lenders, and real estate brokers that private flood insurance is “just like” the traditional NFIP flood policy. This is not accurate. Agents should carefully compare any private flood insurance policies they offer to make sure that coverages are adequate and appropriate for policyholders.

From a rating perspective, private flood insurance companies vary broadly in their underwriting and rating methods. Some private flood companies are using computer models and do not require or utilize base flood elevations. These nonadmitted / surplus lines markets can change their underwriting and rating at any time and in any manner they choose.

Financial Security

Traditional wisdom has been that the private insurance market does not have the capacity to handle the inherent adverse selection and mega-catastrophe risk of flood insurance. That is why the National Flood Insurance Program was created with the backing of the federal government.

Because of the excess capacity in the insurance and reinsurance markets in recent years, some insurance and reinsurance executives now claim to have the capacity to write flood insurance. Some even question the need for the National Flood Insurance Program. This raises a couple of concerns.

First, long years of experience have taught us that reinsurance markets can fluctuate wildly. When loss experience is good, the industry ends up with excess capacity. However, when increased catastrophe losses hurt reinsurance markets, capacity can quickly disappear and both availability and affordability of insurance can become serious problems. What happens to the private flood insurance market when markets harden? What is the impact on the NFIP?

Second, private flood insurance written by nonadmitted / surplus lines insurers do not have the backing of the federal government or the Louisiana Insurance Guaranty Association (LIGA). In the event of a major flood catastrophe, such as Super Storm Sandy or Hurricane Katrina, will private flood insurers be able to pay all of the claims? What happens if some of these private flood insurance programs cannot pay all of their claims? Will they be able to continue providing the same private flood insurance capacity after such storms?

Agents E&O Concerns

Private flood insurance might be the right solution for certain customers. However, the issues outlined above raise a number of potential errors & omissions concerns for agents. Agents need to understand these issues and carefully advise their customers whether NFIP or private flood insurance is the best alternative for them. As always, documentation of the policyholder's choice is very important.

Necessary Action: Circulate this Technical Advisory to all appropriate agency staff. Discuss private flood insurance with your WYO flood insurance companies and come to an agreement about who, what when and how the appropriate NFIP and/or private flood insurance quotes will be provided to your clients. Establish agency procedures for quoting, writing, and documenting the placement of private flood insurance policies.

Please note that this Technical Advisory is intended to be educational and is not legal advice upon which you should rely. Please seek any legal opinion you may need from a qualified attorney.