HOW TO CREATE A MORE ROBUST AND PRIVATE FLOOD INSURANCE MARKETPLACE

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND INSURANCE

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

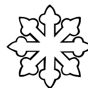
ONE HUNDRED FOURTEENTH CONGRESS

SECOND SESSION

JANUARY 13, 2016

Printed for the use of the Committee on Financial Services

Serial No. 114–68



U.S. GOVERNMENT PUBLISHING OFFICE

99–799 PDF WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
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HOW TO CREATE A MORE ROBUST AND PRIVATE FLOOD INSURANCE MARKETPLACE

Wednesday, January 13, 2016

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:19 a.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Garrett, Pearce, Posey, Hurt, Ross, Barr, Rothfus, Williams; Cleaver, Velazquez, Green, Beatty, and Kildee.

Ex officio present: Representatives Hensarling and Waters.

Also present: Representative Murphy.

Chairman LUETKEMEYER. Okay. Mr. Cleaver managed to make it through our Washington traffic here and has joined us. So let's call the subcommittee to order.

The Subcommittee on Housing and Insurance will come to order. Today's hearing is entitled, "How to Create a More Robust and Private Flood Insurance Marketplace."

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Before we begin today, I would like to thank the witnesses for appearing today. I look forward to your testimony.

And I now recognize myself for 2½ minutes to give an opening statement.

Flooding has devastated large areas of my home State of Missouri as well as the neighboring State of Illinois, tragically claiming lives and causing millions of dollars of damage. In the past several months, we have seen similar situations from South Carolina to southern California. Unfortunately, these are not isolated incidents. Flooding continues to be the most prevalent natural disaster in the United States. As communities in Missouri and across the Nation begin to put their lives back together, it is fitting that this subcommittee continues to examine flood insurance and the current construct of the National Flood Insurance Program (NFIP). Yesterday, this subcommittee held a hearing to discuss the state of flood insurance in America.

Last week, I convened a roundtable discussion on flood mapping. What has become evident is that total reliance on insurance coverage for the NFIP is inadequate. Members agree across party lines that policyholders, communities, and taxpayers deserve better. One

of the first steps toward reform is to allow policyholders to access market-based flood insurance policies.

H.R. 2901, the Flood Insurance Market Parity and Modernization Act of 2015, introduced by the gentleman from Florida, Mr. Ross, and the gentleman from Florida, Mr. Murphy, would allow for greater consumer choice and private market participation. It does so under the close supervision of the State Insurance Commissioners, the foundation of the regulatory system we have worked in an overwhelming bipartisan fashion to protect. By removing the ambiguity around what qualifies as acceptable flood insurance, property owners will be assured of greater options and flexibility in their choice of policies. Providing private competition to the publicly administered NFIP will also promote competition in markets which have previously been underserved.

I owe it to my constituents back in Missouri, and to all Americans who have suffered from flood damage, to create a program for flood insurance that is stable, accessible, and cost-effective.

Before I yield to the ranking member, I ask unanimous consent to insert into the record letters on H.R. 2901 from the NAIC, PCI, AIA, NAMIC, NAPSLO, the Big "I," CIAB, the National Association of Professional Insurance Agents, the Financial Services Roundtable, the SmarterSafer Coalition, the Reinsurance Association of America, the National Association of REALTORS®, MBA, ABA, and the National Multifamily Housing Council and the National Apartment Association. As you can see, there is wide support across the industry spectrum for this alternative to our present system.

Without objection, it is so ordered.

The Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, Mr. Cleaver, for 5 minutes for an opening statement.

Mr. CLEAVER. Thank you, Mr. Chairman. Let me, again, thank you, as I did yesterday, for the very proactive step you have taken toward dealing with the issue of insurance before it becomes caught up in a critical year where we are not going to have a lot of workdays. And I think it is appropriate for us to continue, as you have already begun, hearing issues that relate to flood insurance. We discussed yesterday, I think rather broadly, the NFIP, and we highlighted areas where there is room for improvement and discussed ways in which the NFIP could be reauthorized.

Today is our second hearing on flood insurance, and today we will be discussing the role of private insurance in the flood insurance market, which is a significant issue and a significant concern. And we dealt with it yesterday, but I think the key to this whole issue is whether or not the private sector is interested in and willing to become intimately involved in this program. We have attempted this over the years. The program was created in 1968 to provide flood coverage to consumers who were unable to get coverage from the very limited private market. The NFIP is responsible not only for providing flood insurance, but for developing flood maps and promoting mitigation activities.

One of the things that I think we all have come to see is that flooding can occur anywhere. I grew up in a flat part of Texas, the Dallas area on toward probably until you get to Palo Duro Canyon

around Amarillo is just flat. And last summer, in this flatland, there was all kinds of flooding. And we do know that it can and does occur everywhere, and can have a devastating impact on our communities. But one of the things we have also learned is that when these major events occur, like Hurricane Katrina, it pretty much decimates any private participation and the government has had to do a lot of backstopping, both for Sandy and Katrina.

And then as we begin to discuss reauthorization of the program, I think we have to ensure products remain affordable and available. Our conversation must also focus on the importance of obtaining accuracy in our mapping, which is a really big issue in the rural part of the 5th District, which I represent in Missouri. And as mapping and risk technology has developed since the creation of the NFIP, the appetite for private insurers to re-enter the flood market has grown.

And so, I look forward to hearing our witnesses today discuss ways in which the private role in flood insurance could grow.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman LUETKEMEYER. The gentleman yields back. With that, the Chair now recognizes the gentleman from Florida, Mr. Ross, for 2½ minutes for an opening statement.

Mr. ROSS. Thank you, Mr. Chairman. And thank you very much for holding this important hearing about an issue to which I am dedicated. And that is, providing American homeowners more affordable consumer options in the flood insurance marketplace. I would also like to thank our distinguished guests for their testimony today, and Representative Patrick Murphy for joining me in introducing the Flood Insurance Market Parity and Modernization Act, which we will be discussing this morning.

Since joining the House Financial Services Committee, I have urged my colleagues to work with me to address the shortcomings of the current government flood insurance model known as the National Flood Insurance Program. Yesterday, we held our first in a series of hearings to examine the problems with this Federal program, and to explore solutions that benefit homeowners. Floridians and Americans across the country would greatly benefit from more choices when it comes to flood insurance policies, and private competition in this market will lead to greater innovations and more affordable and comprehensive policies for consumers.

Unfortunately, regulatory barriers and the bias of regulators favoring NFIP policies have prevented the development of a private flood insurance marketplace. This was not the intention of the Biggert-Waters Act. Rather, it was an unintended consequence. With Florida homeowners in mind, I introduced H.R. 2901, the Flood Insurance Market Parity and Modernization Act. This bipartisan legislation will remove the unnecessary regulatory barriers that are hindering consumers' flood insurance options.

As the primary insurance regulator for my home State of Florida, I am proud that our Commissioner of Insurance Regulation, Kevin McCarty, has offered his full support of this legislation. I urge my colleagues on both sides of the aisle to join me in enacting this commonsense, bipartisan legislation that will encourage the expansion of a well-regulated, more affordable private flood insurance option for homeowners. And I yield back.

Chairman LUETKEMEYER. The gentleman yields back.

With that, we want to begin our testimony, and we welcome all of the panelists today: Ms. Teresa Miller, Commissioner, Pennsylvania State Insurance Department, testifying on behalf of the National Association of Insurance Commissioners; Mr. Steven Bradshaw, Executive Vice President, Standard Mortgage, on behalf of the Mortgage Bankers Association; Mr. Brad Kelley, Executive Director, National Association of Professional Surplus Lines Offices; and Mr. Birny Birnbaum, Executive Director, Center for Economic Justice.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, your written statements will be made a part of the record. Just a quick primer on the lighting system: green means go; when you get to yellow, you have one minute to wrap up; and when it turns red, I am the one who has the last word. So we will hopefully stop there shortly thereafter.

With that, I want to recognize the gentleman from Pennsylvania, Mr. Rothfus, to introduce our first witness.

Mr. ROTHFUS. Thank you, Mr. Chairman.

It is my privilege to welcome Pennsylvania's Insurance Commissioner, Teresa Miller, to the Financial Services Committee today. Commissioner Miller was confirmed to her role in June of last year. In that capacity, see oversees the fifth largest insurance market in the country, and the fourteenth largest in the world in terms of premium volume. This is a significant and challenging responsibility in our large and diverse State.

Fortunately, Commissioner Miller brings years of experience to her new appointment and to our subcommittee today, having previously served in Oregon's insurance division as well as in the private sector. She will be speaking to us today not just as Pennsylvania's Insurance Commissioner, but also as an active NAIC member.

Commissioner Miller serves on the Federal Advisory Committee on Insurance (FIO), providing advice and recommendations to the Federal Insurance Office on issues such as automobile insurance affordability, and international insurance developments. Given Pennsylvania's history of flooding, and ongoing concerns about the impact of flood insurance policy on its citizens, I expect Commissioner Miller to provide welcome insight into the future of the NFIP and impactful reforms for the committee to consider. Thank you again for coming, Commissioner Miller, and I yield back.

Chairman LUETKEMEYER. With that, Ms. Miller, you are recognized for 5 minutes.

STATEMENT OF TERESA D. MILLER, COMMISSIONER, PENNSYLVANIA STATE INSURANCE DEPARTMENT, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

Ms. MILLER. Good morning. Thank you, Chairman Luetkemeyer, and Ranking Member Cleaver. And thank you, Congressman Rothfus, for your kind introduction. I appreciate the opportunity to testify today to provide State insurance regulators' views on issues surrounding the development of a private flood insurance market. Facilitating increased private sector involvement in the sale of

flood insurance will help promote consumer choice and spur competition. It will also provide homeowners necessary coverage, often at greatly reduced costs. In Pennsylvania, we are finding that in many cases, private carriers are willing to offer comparable coverage at substantially lower cost than NFIP. In one instance, a property owner would have paid a $7,500 annual premium with the NFIP, but found private coverage for a little over $1,400.

Another homeowner was quoted a $6,000 annual premium by NFIP, but found a private policy for $900. Like other types of new coverages, private flood insurance is being developed and offered first by the surplus lines insurers. These insurers typically insure unique or otherwise difficult to underwrite risks that the admitted market is at least initially reluctant to insure. As detailed in my written testimony, we have significant authorities to ensure consumers in the surplus lines market are well-protected. These authorities include capital, surplus, and eligibility requirements on surplus lines carriers, as well as the ability to hold both the insurer and the broker responsible for any misconduct.

As the private flood insurance market grows and more companies offer coverage, including admitted companies, our regulation will continue to evolve to meet the size and the breadth of the market as well as the needs of consumers. However, more can be done to help facilitate the development of this market, providing consumers more choices and more affordable coverage.

One of the objectives of the Biggert-Waters Act was to create opportunities for the growth of the private market as an alternative to the NFIP. Unfortunately, the definition of and the regulatory environment surrounding private flood insurance is at odds with this objective, making it more difficult for insurance regulators to protect consumers and ensure availability. The Flood Insurance Market Parity and Modernization Act addresses these concerns, which is why I am here today to support it.

Specifically, we find it troubling that Biggert-Waters empowered Federal banking and housing regulators and the GSEs to apply their own requirements related to the financial solvency strength or claims-paying ability of private insurance companies from which they will accept private flood insurance. This is highly problematic as banking and housing regulators have neither the expertise nor the experience to regulate insurance companies or markets. Moreover, they have regulatory objectives that while laudable, are fundamentally different than insurance consumer protection and fostering competitive insurance markets.

They are simply ill-suited to regulate insurance, and it is inappropriate for them to have the authority to substitute their judgment for those charged under the law with regulating insurance products and protecting policyholders. To address this, H.R. 2901 includes important language clarifying that State insurance regulators have the same authority and discretion to regulate private flood insurance as they have to regulate other similar insurance products and markets. We very much appreciate these clarifications as they are critical for NAIC's support for this legislation.

Another impediment for entrants into the market is the vague definition of private flood insurance included in Biggert-Waters. In order for a private market to evolve, insurers need flexibility to tai-

lor insurance products to meet consumer needs. Biggert-Waters does not allow for innovation, but rather focuses on ensuring policies don't deviate from its rigid criteria. This is despite the fact that private insurers may be able to offer additional coverage features or greater limits at a more affordable price.

H.R. 2901 provides a clearer definition of private flood insurance by clarifying that State insurance laws solely govern over the insurance transaction. It will ensure that State insurance regulators have the flexibility to approve private flood insurance coverage that is responsive to the needs of their States and constituents, while complying with their State's regulatory requirements. These clarifications will assist in removing the restrictive and confusing language in current law to help prompt more insurers to enter the market if they are willing.

In conclusion, State insurance regulators support efforts to further develop the private market to help provide consumers with access to additional options for flood insurance products and coverage at potentially more affordable prices.

We appreciate very much Congressmen Ross and Murphy's leadership on H.R. 2901, and look forward to continuing to work together as this bill moves forward. I appreciate very much the opportunity to be here on behalf of the NAIC. Thank you.

[The prepared statement of Commissioner Miller can be found on page 129 of the appendix.]

Chairman LUETKEMEYER. Thank you, Ms. Miller.

Mr. Bradshaw, you are now recognized for 5 minutes.

STATEMENT OF STEVEN BRADSHAW, EXECUTIVE VICE PRESIDENT, STANDARD MORTGAGE, ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. BRADSHAW. Good morning, Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee. My name is Steve Bradshaw, and I appreciate the opportunity to testify today on behalf of the Mortgage Bankers Association.

I am currently executive vice president of Standard Mortgage Corporation, a lender and servicer headquartered in New Orleans, Louisiana. The company was founded in 1925 and currently services approximately 28,000 residential mortgage loans throughout the southeast.

This past August marked the 10th anniversary of one of the most significant flood events in U.S. history, Hurricane Katrina. We experienced the massive devastation firsthand. Approximately 3,500 of our servicing customers sustained significant flood damage to their homes. And on a more personal note, nearly two-thirds of our staff lost their homes.

As a result of Hurricane Katrina and two other significant storms in the fall of 2005, more than one million housing units were damaged across five States. There is no doubt that the National Flood Insurance Program was the key component to the Gulf Coast recovery, just as it has been for other communities across the country that have sustained major flooding or are flooding today. But there is also no doubt that the NFIP needs to be reformed. The program is now $23 billion in debt and is simply not sustainable

as it is. The Federal Government cannot and should not bear the full burden of post-disaster recovery.

Congress recognized when it passed Biggert-Waters that private sector flood insurance must be allowed to develop in order to ensure a stable, sustainable, and affordable market. Expanding flood insurance options will make it easier for more homeowners to obtain flood insurance. And a competitive flood insurance market will expand available insurance options, lower cost, and increase the number of at-risk properties that are insured. In other words, we are expanding the pool.

For example, many homes that were destroyed in Katrina were not located in a special flood hazard area. Homes outside those zones are not required to have flood insurance. As a result, mortgage servicers like us were liable for the cost when those homes were wiped out. The MBA believes that increased private sector involvement can also serve to shift some of the burden—not all of the burden—of post-disaster recovery away from the Federal Government and to the private sector. This will limit taxpayer exposure to future flood losses.

In light of this, we support H.R. 2901, the Flood Insurance Market Parity and Modernization Act. The bill provides two important improvements to the NFIP. First, the bill clarifies what constitutes an acceptable private flood insurance policy by providing a clear definition of private flood insurance. This will make it easier for lenders to accept private policies to satisfy the mandatory purchase requirement.

Second, H.R. 2901 addresses lenders' concerns regarding continuous coverage requirements. Under current law, it is unclear whether someone previously covered under an NFIP policy who moves to a private sector policy would be eligible to return to the NFIP policy at their previous rate. We are pleased that H.R. 2901 eliminates this disincentive for consumers to choose a private policy. It does so by clarifying that private flood insurance satisfies the continuous coverage requirement.

In summary, MBA supports H.R. 2901 as a simple way to encourage the growth of a competitive private flood insurance market. Increased private sector involvement will hopefully expand available insurance options for borrowers, lower cost for consumers, and reduce taxpayer exposure to flood losses over time. We are especially grateful for the leadership shown by Representatives Dennis Ross and Patrick Murphy on this legislation, and we urge the subcommittee to approve it.

Thank you, again, for the opportunity to testify today. The MBA commends your efforts to expand the private flood insurance market, and I look forward to any questions you may have.

[The prepared statement of Mr. Bradshaw can be found on page 63 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Bradshaw.

Mr. Kelley, you are recognized for 5 minutes.

STATEMENT OF BRADY KELLEY, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS LINES OFFICES (NAPSLO)

Mr. KELLEY. Good morning, Chairman Luetkemeyer, Ranking Member Cleaver, Chairman Hensarling, and members of the subcommittee. My name is Brady Kelley. I am the executive director of the National Association of Professional Surplus Lines Offices based in Kansas City, Missouri. Thank you for inviting me here today to testify on H.R. 2901.

Surplus lines is a $40.2 billion market. And NAPSLO members broker and underwrite a very high proportion of that. Our market, often referred to as the nonadmitted market, exists to provide insurance coverage for nonstandard and complex risks, and to provide cover for risks that exceed what the standard market is either willing or able to underwrite. It is the State's approach to regulating that market, which includes providing what is freedom from rate and form regulation, that allows it to work as this effective supplement. This fundamental principle is part and parcel to its effective operation and regulation.

Consider, for example, the impact of catastrophic losses that cause standard carriers to either withdraw or significantly curtail underwriting in certain regions of the country, or in certain lines of business. Exhibit one of our testimony tries to illustrate that. Market responses to catastrophic events by measuring the rates at which surplus lines premium has shifted either up or down over time in relation to total U.S. property casualty premium. You see events like the Northridge earthquake, 9/11, and hurricanes in 2005. They were all followed by very clear spikes in surplus lines premium, spikes that exceed the growth of the overall property casualty market. And then you see the reverse being true in years following that where catastrophe losses are lower or as the standard market re-adjusts. Without this safety net, consumers would be left without coverage for their commercial risks and/or their personal assets.

These same fundamentals apply in the case of private flood insurance. Consumers whose flood risks do not fit within the terms and limits of the NFIP, or whose risks are declined by the standard market, will look to our market, surplus lines, for the solution. It is important to point out that this is not new. Why might that be? Property exposures may exceed the $250,000 limit within the NFIP on a residential property, or the half million dollar limit on a commercial property. Homeowners may want replacement coverage rather than actual cash value for their property. They might want to insure additional structures, or list other properties on one policy. They might need additional living expense, basement exposure, and/or business interruption for a commercial entity.

These examples, coupled with communities or zones that are not eligible for NFIP coverage, mean consumer alternatives are absolutely essential. Our written testimony includes some facts and figures about the size of the surplus lines flood insurance market, and while you will see that they represent a relatively small proportion of the overall market, without it, consumers who need it would have no alternative.

This is precisely why we strongly support H.R. 2901. Although our market is currently allowed to provide private flood insurance, the 2012 law created uncertainty for lenders and consumers. Specifically, lenders became uncertain about accepting surplus lines policies in light of the law's requirements, and because it authorized Federal banking and housing regulators to apply their own requirements on private insurance companies. No regulations have been developed since that time. And it is prolonging this uncertainty. Uncertainty is the problem, but H.R. 2901 is the fix. It simply ensures our market's continued role in solving unique and complex flood risks that exceed or differ from the options available through either the NFIP or the standard market.

In addition, H.R. 2901 maintains the authority and primacy of State Insurance Commissioners in regulating private flood insurance. Because of their experience, their strong track record, and their success in regulating the U.S. business, we obviously strongly support that.

We have also provided written testimony describing how the States regulate the surplus lines market. I think Commissioner Miller has already done a pretty thorough job of describing that. So let me simply reiterate the importance and degree of each State's authority over both the insurance company and the surplus lines broker in a surplus lines transaction.

As a result, the 2015 A.M. Best report illustrates an exemplary solvency record for our market. It is included as another exhibit in the testimony. H.R. 2901 will solve the problems and concerns shared by the insurance and banking industries by preserving our market's ability to offer options to consumers. Without it, consumers who need it will have no alternative. Legislators on both sides of the aisle have expressed a desire to not just extend, but to also improve the NFIP going forward. And I think the witnesses over the last couple of days certainly agree with that. We believe H.R. 2901 is a positive step in that direction because it enables the private market to develop, and it allows the NFIP to focus on those properties with repetitive losses and their goal of flood loss mitigation and prevention.

We appreciate Congressmen Ross and Murphy for introducing the bill. Again, we thank you for the opportunity to be here. We look forward to working with you as this bill moves forward. Thank you.

[The prepared statement of Mr. Kelley can be found on page 68 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Kelley.

And Mr. Birnbaum, you are recognized for 5 minutes.

STATEMENT OF BIRNY BIRNBAUM, EXECUTIVE DIRECTOR, CENTER FOR ECONOMIC JUSTICE

Mr. BIRNBAUM. Thank you. Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee, my name is Birny Birnbaum. Thank you for the invitation to speak to you today.

The availability and affordability of flood insurance is a critical issue for individual and community well-being, economic development, and a resilient and sustainable future. I have worked on

these issues for over 20 years as an insurance regulator, consulting economist, and consumer advocate. Your invitation to testify asked whether the NFIP, as it is presently constituted, represents an ideal model for the effective protection of residential and commercial property owners from damages relating to flooding. The answer to that question is a resounding "no" for a number of reasons. The primary problem of the NFIP is the multiple and conflicting goals that Congress has tasked the Program with, and the constraints and requirements Congress has placed on the Program. The starting point for Congress and the Federal Government should be a laser-like focus that Federal expenditures related to flood promote more resilient and sustainable homes, businesses, communities, and infrastructure against the peril of flood.

With this as the clear goal, any proposal regarding the NFIP can be evaluated by asking, "Does this change promote resiliency and sustainability or not?" The reason why resiliency and sustainability must be the overarching goal for restructuring the NFIP is that there is no insurance mechanism—public, private, or combo—that will be able to finance increasingly frequent and severe flooding. And a focus on resiliency and sustainability means Federal expenditures as investments today to replace disaster relief expenditures tomorrow.

The way forward: There is a great opportunity for greater reliance on private insurers and markets to provide flood insurance, but H.R. 2901 is not the approach to accomplish this. And certainly, it's not the approach to make the NFIP more financially sound or achieve greater resiliency and sustainability. The best approach for Congress to achieve these goals is to require that flood be covered in standard residential and commercial property insurance policies, and subject to the same State-based regulatory framework that exists for homeowners and commercial property insurance today.

There are four key actions needed by 2017:

One, get the NFIP out of the business of being a flood insurance company by requiring that residential and commercial insurance policies sold by private insurers cover the peril of flood. That requirement turns flood back to the States where all other property insurance products and markets are regulated, and back to private insurers, re-insurers, and catastrophe models who have the capability and capital to provide flood coverage more comprehensively and efficiently than the Federal Government.

Two, transition the NFIP from a direct provider of insurance to a mega-catastrophe re-insurer utilizing the successful model of the Terrorism Risk Insurance Program.

Three, address the affordability problem of flood insurance with Federal, State, and local assistance outside of the insurance system, no-subsidies insurance pricing with an overwhelming emphasis on assistance for lost mitigation as the tool to create more affordable premiums.

And four, reauthorize the NFIP during a period of transition.

As we have seen over the last decade, the congressional changes to the NFIP have lurched from efforts that longer-term reform to responses to current crises, with the responses to current crises often contributing to bigger problems down the road. H.R. 2901 is

a response to a current issue. Federal agencies have been slow in promulgating rules regarding private flood insurance and surplus lines insurers see an opportunity to pick off NFIP policies that are mispriced due to NFIP rating practices.

H.R. 2901 will not address the longer-term problems of the NFIP, will not meaningfully promote private market participation in the sale of flood insurance, and will create bigger problems in the future when a flood event occurs. H.R. 2901 attempts to encourage private flood by defining private flood to include surplus lines insurance for residential properties, and by eliminating Federal oversight, removing current consumer protection requirements for private flood, removing the authority of Federal agencies to implement those requirements, and removing the authority of Government-Sponsored Enterprises (GSEs) to establish standards for the claims-paying ability of insurers, which they already do now for hazard insurance.

Surplus lines or nonadmitted carriers can be distinguished from admitted insurers in the following ways: Admitted insurers are licensed by a State insurance department to sell certain types of insurance. These insurers are subject to regulatory requirements for the filing and approval of policy forms and rates, are subject to the State's consumer protection laws regarding unfair trade practices and unfair competition, and importantly, participate in the State guaranty fund, which pays claims in the event the admitted insurers become insolvent.

In contrast, surplus lines insurers are not licensed by State insurance departments. Rather, the State department regulates surplus lines agents who are authorized to place coverage with a surplus line insurer on a list of acceptable insurers. Surplus lines policy forms and rates are not subject to regulatory oversight, and surplus lines insurers do not participate in State guaranty funds.

I understand the theory behind H.R. 2901 is that admitted insurers are not willing to write private flood, but surplus lines insurers would be if certain requirements, such as comparability with the NFIP policy or claims settlement requirements, were relaxed.

The story continues that once surplus lines insurers are offering private flood, admitted insurers will be more comfortable. I have seen no empirical evidence to remotely suggest admitted carriers will do as suggested. I have seen surplus lines insurers write business that admitted insurers would have written, and I have seen personalized business migrate from the admitted market to surplus lines when permitted to do so to take advantage of fewer consumer protection requirements.

The actual results of these changes will be for surplus lines insurers to cherry-pick NFIP policies that are currently overpriced due to the NFIP's broad rating scheme and loadings for contingency and reserves. While the surplus lines insurers take the profitable low-risk policies, the NFIP will become even more financially vulnerable as its premium revenue will decline far faster than its risk exposure. H.R. 2901 will not only create financial problems for the NFIP in the future, it will set the table for more problems—

Chairman LUETKEMEYER. Mr. Birnbaum, can you wrap this up quickly? You are over—

Mr. BIRNBAUM. Yes.

—when a flood occurs. Since the States don't regulate policy forms, these policies can contain exclusions that a regulator would never approve, and a policy filed by admitted insurers.

In summary, flood insurance markets, in particular, are not competitive. So unleashing unregulated insurers on vulnerable consumers without Federal oversight and without meaningful State oversight is a recipe for disaster.

Thank you.

[The prepared statement of Mr. Birnbaum can be found on page 42 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Birnbaum.

We will begin our questioning. And I will start off. I recognize myself for 5 minutes.

Ms. Miller, you made a comment a while ago with regards to the GSEs being able to regulate insurance versus the private market, which would have to be overseen by you. Can you explain what you are talking about there a little bit, because I think it is a key point of what we are looking at this morning with regards to regulatory oversight.

Ms. MILLER. Absolutely. Thank you, Mr. Chairman. Banking and housing regulators have regulatory objectives that are simply fundamentally different than insurance consumer protection, and promoting competitive insurance markets. So, our view is that they are ill-suited to regulate insurance. And it is really inappropriate for them to be given the authority to substitute their judgment for those of us who are charged under the law with regulating insurance. State regulators have 140 years of regulating and supervising the business of insurance, and protecting policyholders and really balancing the availability of coverage with solvency. I think, to put it very bluntly, banking regulators don't have a mandate of consumer protection. And State regulators, that is what we do. That is our charge.

Chairman LUETKEMEYER. So basically, what you are saying is the GSEs are usurping your authority to be able to oversee and qualify the different policies of the private sector? Is that what you were just saying?

Ms. MILLER. That is correct.

Chairman LUETKEMEYER. Okay. Thank you.

Mr. Bradshaw, you talked a little bit about some of the folks who were not covered by flood insurance, especially in Katrina. And you sort of alluded to the fact that there is concern there because flood affects a lot of people beyond the floodplain. So would you consider—or are you alluding to the fact that you would like to see everybody required to have this, or that the lenders have more leeway in requiring people to have flood insurance, or did I misunderstand what you just said?

Mr. BRADSHAW. With regards to requiring everybody to have flood insurance, the answer to that is no, that is not the position of Standard Mortgage. It is certainly not the position of the Mortgage Bankers Association. With regards to expanding the options for insurance coverage to be available, we, Standard Mortgage, are very interested in that.

During Katrina, there were a number of people who were flooded. Due to the nature of FHA insurance, just as an example, if

someone floods and they are not in a flood zone, so there is no flood insurance, and if they then abandon their home, then under the FHA program, it is up to Standard Mortgage to repair the home in order to file the claim against FHA.

That puts us in the business of insuring FHA. So we believe with a new type of program that could be developed by private insurers, that other people may be interested in obtaining insurance even when they are outside the zone.

Chairman LUETKEMEYER. Okay. Thank you.

Mr. Kelley, Mr. Birnbaum made a statement a minute ago that caught my attention that surplus lines don't belong to the Guaranty Associations of States. Did I understand that statement correctly, Mr. Birnbaum? Did you make that statement?

Mr. BIRNBAUM. Yes.

Chairman LUETKEMEYER. Okay. That is a very key point from the standpoint, I think, that surplus lines are where you look to be able to provide flood insurance. Is that the case, Mr. Kelley?

Mr. KELLEY. It is the case. Surplus lines insurers do not—they are not backed by guaranty funds. But there is good reason for that. If you look at the types of coverages written in the surplus lines market, there are oftentimes not coverages that would fall under the general limits of the guaranty that exists for the standard market. You also have, again, the A.M. Best report that shows an incredible solvency record for the surplus lines market: 11 years of no financial impairments, compared to, I think, 207 impairments in the standard market over that same time period.

If you look at the ratings of surplus lines carriers, they are all in the excellent-to-good category compared to ratings on the standard side that aren't quite as good. So we tend to believe that coverage is typically inadequate for the size and limits of commercial policies covered by surplus lines carriers. We believe they don't incentivize strong corporate financial operations. And guaranty funds, in our opinion, would add an unnecessary burden on the surplus lines consumer, given the stellar financial strength of the industry.

Chairman LUETKEMEYER. Okay. Thank you. My time has expired.

I recognize the ranking member, Mr. Cleaver from Missouri, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Yesterday, I asked our witnesses if any of them believed that we needed to end the NFIP. And there were no hands raised. So I am interested in whether this panel sees it the same way. Do any of you believe that we need to eliminate the NFIP? Just raise your hand if you—

Mr. BIRNBAUM. Yes. I think we need to eliminate the NFIP as a direct provider of insurance and transition it to a mega-reinsurer along the model of the Terrorism Risk Insurance program, because the private market is in a much better position to deliver the coverage of flood in the standard homeowners and commercial property insurance policies than the NFIP with a separate flood insurance program.

Mr. CLEAVER. But wouldn't the rates be higher for the consumers than they are right now for the NFIP?

Mr. BIRNBAUM. I would—no. Certainly for some. But for the vast majority of consumers, the rates would be less because the private market could deliver the coverage of flood far more efficiently. Number one, there are fewer administrative costs because you eliminate a second insurance policy. Number two, you eliminate a lot of claim settlement costs because you no longer have an insurance company and the NFIP both trying to settle a claim and deciding who is responsible for it. We saw problems with that after Hurricane Katrina, which is whether the insurers who are responsible for settling the claims were trying to say: Well, is it a claim that is wind that we cover, or is it a flood coverage that the NFIP will pay for? So there are a lot of reasons why the private market could introduce efficiencies that the NFIP couldn't.

So for the vast majority of consumers, the actual coverage for flood would be less expensive than from the NFIP. And, of course, there still remains the issue that for some consumers, it is unaffordable. And that still has to be addressed the same way it does for the NFIP.

Mr. CLEAVER. Mr. Kelley, do you agree? And also, do you think that we would actually have consumers who would pay the full risk rate in substantial enough numbers to make the program work?

Mr. KELLEY. I don't agree. Sorry. I don't agree that we need to eliminate the NFIP entirely. We certainly agree it needs to be reformed. I keep going back to this GAO report and the note that they made about subsidized properties counting for the majority of the repetitive loss properties in the market. And I heard it yesterday during the testimony as well. One percent of all NFIP policies count for 30 percent of all claims paid. So I think we have to face it there. That one percent category of property, no one is attracted in insuring those properties. And to think that you could come up with an actuarially sound rate that covers the risk of that property, I can't imagine a consumer having the ability to afford that.

So we believe there is a need for the NFIP to serve as some level of backstop. But we think you can focus it down on that category of risk.

Mr. CLEAVER. So a hybrid?

Mr. KELLEY. Maybe. I think, again, H.R. 2901 is going to shift as much business as possible to the private industry. But let's face it. Private industry is not—they are going to have trouble insuring that one percent category as well without a pretty reasonable rate. So if you focus on that one percent category, maybe focusing NFIP on their mission of mitigating flood losses, preventing flood losses, that, in our opinion, is a better focus of a reformed NFIP.

Mr. CLEAVER. So, Mr. Bradshaw, do you think if shifting exposure to the private sector is going to be just too much for them to bear—we have tried this before. So, we are talking about shifting more and more exposure to the private sector. Do you think that would run away private sector participation, or would they be jumping for joy?

Mr. BRADSHAW. We don't know what the private sector is going to do because they are not in that business on a large role today. So it is something to us that is worth trying. Of course, in Louisiana, we have a high concentration of risk. We are very eager to have as many choices in order to expand homeownership and to

provide an affordable option. And, to me, there may be something akin to the relationship we have with the FHA and the GSEs and the Thrifts and everybody that is serving—

Mr. CLEAVER. That is bad for my colleagues here. So use another—no. Inside. Go ahead.

Mr. BRADSHAW. There is a—pardon me for going off. We are interested in expanding options. We are interested in seeing flexibility for the consumer.

Mr. CLEAVER. Thank you. I will yield back the balance of my time, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman yields back. With that, I recognize the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman. I appreciate your testimony. Ms. Miller, thanks. Your testimony is extraordinarily clear and precise, especially in the recommendations.

You recommend that more flexibility is needed under Biggert-Waters. Could you describe that flexibility just a little bit? Flesh that out a little bit more? What would it look like?

Ms. MILLER. Congressman, I think what we are looking for is a clear definition of private flood insurance. That has been one of the biggest difficulties with the Biggert-Waters Act is that the definition is just not very clear, and it has created—

Mr. PEARCE. If we were to ask you, would you have a sentence that would clarify that?

Ms. MILLER. I think that's what H.R. 2901 does. It provides that—

Mr. PEARCE. And you think that it completely does that?

Ms. MILLER. Right.

Mr. PEARCE. Okay. I needed reassurance. For my friend, Mr. Ross, sometimes has to be at—brand him to make sure. Okay.

And, Mr. Kelley, your testimony seems to hint that there is not much reason for a private market. But that is pretty much in contrast to Ms. Miller's. Do you not find the private market—in other words, she gave three examples. And if three people can get insurance, then it is almost out there for everybody. Do you not find examples of that, or is this something specific to her State?

Mr. KELLEY. No. I don't mean to suggest that. I think there are opportunities. What we have tried to specify and what we have to go back and reiterate is that the surplus lines market is generally not the market of first resort. It is a market that exists to supplement what the standard market isn't willing to underwrite. They are not approved to write it. They don't have the—

Mr. PEARCE. But you heard her examples. She gave them, and then they are in her written testimony. This one, this one, this one, went out and they got it, and they got it cheaper.

Mr. KELLEY. Right.

Mr. PEARCE. And sitting up here, not knowing a thing about insurance, except that I pay for it once in a while, usually my wife does, but not knowing much more than that, it is confusing. And that is all I am trying to solve. I am not trying to pick at you or anything like that. So you don't find the private market as viable as she does? That is all I want to understand.

Mr. KELLEY. I am confusing you. I don't mean to suggest that. I think her examples are good ones. And there was an example given yesterday by a Member here. I think it was a property in Florida where part of the property is in the flood zone, but the structure itself was way up on the hill. It is never going to see water. The fact that our market, surplus lines market, can come in and specifically underwrite that property, even though it is classified a specific way by the NFIP, we can say we know that structure is never going to flood and we can—

Mr. PEARCE. Okay. Yes, so that gives me the impression that it is a specialty market for special circumstances.

And, Ms. Miller, again, is that the case that these three examples you gave, they weren't just people going out and shopping off the shelf. These were examples where somebody specifically went and said: Oh, we will insure that. That is pretty easy and that is not like the rest of the flood, or was it kind of a broader market? That is all I am trying to assess.

Ms. MILLER. Congressman, it is a good question. And I don't mean to suggest that this is big market even in Pennsylvania. We are starting to see increased interest by our surplus lines carriers in particular. But the examples I gave you are examples my department is aware of. But I am not trying to—this is still a very limited market. I am not trying—

Mr. PEARCE. Okay.

Ms. MILLER. Frankly, from my perspective, I would like to see if we could grow it and make sure that consumers know that—

Mr. PEARCE. Fair enough. I think many of us would like to see that same thing.

Mr. Birnbaum, Ms. Miller adequately points out, and she is talking about making sure that there is viability. Mr. Kelley has, on page 9 of his report, and I am sure you dissected it as well as I did. But on page 9, he has the rating agencies. If you took the time to watch the movie, "The Big Short," and if you watched the circumstances play out, the financial industry had all the rating agencies. And, frankly, they were rigging the game. The triple A's weren't triple A at all. And some people made a whole lot of money by saying they are going to fail, and they did.

So if we were to look at the soundness of the ratings that—the Best ratings I think Mr. Kelley referred to, in your experience, would that tell us that those ratings are going to be adequate? Are they—is that game cooked, too, and we just haven't found it out yet?

Mr. BIRNBAUM. Well, first note, it is not adequate. If you look at the way State insurance regulation deals with admitted carriers, there is extensive oversight of the financial condition of admitted carriers, which is far more extensive than over surplus lines carriers, number one. But, number two, this whole idea that somehow Biggert-Waters gives the GSEs responsibility for financial regulation of insurance companies is a real mischaracterization. Saying that they can determine the claims-paying ability means that they can require that the insurer have a certain credit rating of say an A.M. Best rating of B or more, which is precisely what they do now for hazard insurance.

So Biggert-Waters doesn't give regulatory authority to the GSEs. It simply says you don't have to take any insurance policy that comes your way. You can require an insurance policy with an insurer who has demonstrated a claims-paying ability, either by a credit rating agency, a rating of B or more or something along those lines. So that is why it is important to keep that in Biggert-Waters.

Mr. PEARCE. Okay. Thanks. I appreciate it. I yield back, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired. With that, we go to the gentlelady from California, the ranking member of the full Financial Services Committee, Ms. Waters. You are recognized for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman, for holding this hearing. These hearings are very important, because we are dealing with a rather complicated issue of how to have a National Flood Insurance Program that serves our public well.

Let me apologize to everybody for Biggert-Waters. I am the "Waters" of Biggert-Waters. And I have been apologizing for many months, and helping everybody to understand the unintended consequences of Biggert-Waters. And we tried to straighten that out with the bill that we passed that helped to reduce the cost of the premiums to our consumers, et cetera, et cetera.

But I want you to know that I am very interested in whether or not we can have a private/public operation that will do the best job for our constituents. And I have been working with Mr. Murphy and Mr. Ross. And I really do commend them for the attempts that they have made to try and have this a bipartisan issue, this bill that we are discussing today, H.R. 2901.

But I recognize there are some concerns. And I think that, Mr. Birnbaum, you have identified some of the same concerns that I have. But I want to know from you, do you think it is possible to have more private participation and involvement in the ways that Mr. Ross and Mr. Murphy would have it? And do you think we can work this out?

Mr. BIRNBAUM. I think yes, absolutely, we can get more private market involvement in flood insurance. But with respect, I don't think H.R. 2901 is the way to go with that. One of the problems with the NFIP is the various and conflicting requirements. Make insurance affordable, but not only have premiums that are sufficient to pay claims, but pay back all of the claims in the past that were far in excess of the revenues. When you have those conflicting things, how do you address that? So what would happen with H.R. 2901 is that the surplus lines insurers would cherry-pick certain policies. Right now, the NFIP looks at a special flood hazard area and has 30 different levels of risk, with 1 being the highest elevation and the lowest risks, and 30 being the lowest elevation and the highest risk. They then average the claim cost for that, for everyone in that. Surplus lines insurers are going to come in and pick off everyone from 1 to 14, leaving the NFIP with everyone in 15 to 30, with the result that the NFIP is stuck with the worst and most risky claims, but no more revenue, per se, to deal with that. So you are going to create more financial problems for the NFIP down the road.

The proposal that we put forth fully gives the private market not only the responsibility, but the tools to price the product and utilize all of their means, whether that is catastrophe modeling, catastrophe reinsurance, all of the pricing tools that they can to get flood insurance right.

Ms. WATERS. Would you just briefly describe your proposal?

Mr. BIRNBAUM. The proposal is that Congress, or the States, require that flood be part of the homeowners and commercial property insurance policy. Remember, these are private insurers that are already providing property insurance. So you are just asking them to add the peril of flood. What that would mean is you would have the far more efficient delivery of the coverage of flood, because you wouldn't have to have a second policy. You would have all of the skills and tools of the private insurers who, in pricing, access the catastrophe modelers to get the pricing right. And you would have all of the catastrophe reinsurance and catastrophe bonds and all the alternative capital available to support that.

You would then transition the NFIP to a mega-reinsurer the same way the Terrorism Risk Insurance program works. That has been a successful model. This would accomplish so many things. Not only would it deliver the cost of flood more efficiently, but it would expand flood coverage. It would give consumers the coverage that they expect at the time of an event instead of surprising them with, "There is a flood, and, oh, I am not covered." Or more importantly, how many times have we seen flood in areas that aren't special flood hazard areas?

This would mean that everybody is covered, even if they happen to be outside a special flood hazard area. This will transform Federal expenditures from massive disaster relief to investments in loss mitigation and reduce disaster relief expenditures down the road. This is really the only long-term solution.

Ms. WATERS. If I may, what you are indicating is mandatory insurance for everybody to participate? I agree with you. First of all, the debt that Biggert-Waters attempted to address was just impossible. We could never pay that down or take care of that. So what would you say about constituents who would say, "I don't live in a flood zone. I shouldn't be responsible for those people who decide they want to live in places where they know they are at risk." What would you say to a politician about that?

Mr. BIRNBAUM. The beauty of having the flood as part of the private market, private flood or the homeowners or the commercial property, is that insurers would price the coverage of flood according to the peril. So for consumers who lived in areas that didn't have a high exposure to flood, they would pay little or next to nothing for it. For consumers who lived in a high-flood-risk area, they would pay a lot more. But the private market would reflect these risks a lot more responsively than the NFIP because the NFIP is required to go through this lengthy process with the flood maps. So imagine if that same process were required for wind coverage the way homeowner's insurance is sold today. That would be a disaster for providing wind coverage.

So by turning this over to the market, everyone pays their fair share instead of the system today, which is a bunch of hidden subsidies. Taxpayers are basically—there are some taxpayers who live

in areas without much flood who end up paying for flood because the Federal Government has lent $24 billion to an NFIP that still isn't financially sound.

So there are subsidies not only from one set of NFIP policyholders to others, but there are subsidies from taxpayers to other taxpayers.

Mr. ROSS [presiding]. Mr. Birnbaum, I am going to need you to wrap it up. A little—

Mr. BIRNBAUM. Okay. So by moving this to the private market, you would introduce a lot more equity in the price of flood insurance. And you would make it a lot more transparent.

Ms. WATERS. Thank you very much. I appreciate that. And I am hopeful that you can work with us as we try and figure out what we are going to do to reform the National Flood Insurance Program and have some private involvement in it.

Thank you, Mr. Chairman.

Mr. ROSS. Thank you. The gentlelady's time has expired.

Ms. WATERS. I yield back.

Mr. ROSS. The Chair now recognizes the gentleman from Florida, Mr. Posey, for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman. And, again, I would like to express my appreciation to Chairman Luetkemeyer for holding these hearings and for his efforts to help us get ahead of this issue a little bit.

The National Flood Insurance Program is currently $23 billion in debt. That is about the clearest indication we can ever have that it is not working in its present form. And from the hearings that we have held so far, I am encouraged that at least every Member seems to be able to agree on that.

At one time, an HO-3 was said to have been the broadest, most inclusive form of insurance ever written. HO-3 standard homeowners insurance policy not only covered a lot of perils such as fire and wind at one time, it had liability coverage in it if your kid shot the neighbor with a bow and arrow, and theft provisions, and pretty broad. I don't know if that is still the case, still is considered to be the broadest. But the question I have is a historical one, if any of you could answer it, and that is, if flood was ever included in a standard property insurance policy before, homeowners or otherwise? Can any of you answer that question?

Ms. MILLER. Not to my knowledge.

Mr. BIRNBAUM. I'm sorry. Could you repeat the question? I didn't—

Mr. POSEY. Yes. Was the peril of flood ever before covered by, say, an HO-3 policy in the standard homeowners insurance policy, was it ever covered? And, of course, the next question is, when did it cease to be covered?

Mr. BIRNBAUM. Okay. Basically, Congress created the NFIP in 1968. And that is when private industry came forward and said, "We are not willing to cover flood because the risk is concentrated in certain areas, and we can't diversify it, and we have a hard time identifying the risk because of the flood maps."

Mr. POSEY. So, at one time, it was covered?

Mr. BIRNBAUM. Yes.

Mr. POSEY. Do they cover earthquakes in California? Is that a standard covered peril?

Mr. BIRNBAUM. No.

Mr. POSEY. No. Okay. What do you think would happen if there was a small sentence added to legislation which said, "If you cover any property which has a mortgage insured by the Federal Government, you shall not exclude the peril of flood from the coverage," what do you think would happen?

Mr. BIRNBAUM. I think what would happen is that private insurers would start offering the coverage of peril of flood in their homeowners policies. And if they didn't, then State residual markets would be providing that. So, for example, in Florida, just as, right now, if a company isn't willing to write wind coverage, the consumer would go to Florida Citizens. So if a company wasn't willing to write flood in the policy, then the consumer would go to Florida Citizens. But the ability for companies to write flood today is completely different than it was 40, 45 years ago. Companies have access to catastrophe models. They have access to very distinct and clear and detailed itemization of risk. There is access to reinsurance and alternative capital that didn't exist 45 years ago. So the opportunities are there. There just needs to be a nudge from the government to do so. And that nudge would be a requirement that they include it.

Mr. POSEY. I am not opposed to that concept for sure. But I must say that Citizens puts Florida taxpayers on the hook greater than any other risk ever known to those citizens of Florida. Had Citizens had as broad of coverage pre-2004 and 2005 hurricane seasons as it does now, Florida would probably be in as bad a financial state as Detroit. That is definitely not a real clear answer to have a government-owned insurance company being the largest one in the State with never enough reserves when you live on a hurricane-prone peninsula to cover innumerable losses. Fortunately, our States cannot just print more money and go into debt. They have to actually—they have a constitutional requirement to balance their budget. And they can't pull the escapades that the Federal Government can. So, anyway, I see my time has expired.

Mr. Chairman, thank you very much.

Mr. ROSS. Thank you.

The gentleman's time has expired.

The Chair now recognizes the gentlewoman from Ohio, Mrs. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you so much, Mr. Chairman, and to our ranking member and to our witnesses today. First, let me say that I support what Ranking Waters said in relationship to wanting to be able to look at a public-private operation. So I am going to try to get through two quick questions, one to you, Mr. Birnbaum, and one to you, Mr. Bradshaw, as it relates to the National Flood Insurance Program and privatization.

To you, Mr. Birnbaum, we have certainly heard some interesting testimony here today. And I have had an opportunity to look through your written statement. And one of the concerns I have is the area of moving away from the National Flood Insurance Program to privatization. I am concerned, I am sure my colleagues on both sides of the aisle are concerned or should be concerned, and

I know FEMA is also concerned when you look at the $23 billion in debt. And so I guess my question is if we talk about, as you stated, Mr. Birnbaum, that we move away from privatization and move away from the way it is now to privatization, what happens to the $23 billion in debt? Because certainly one would not expect FEMA or the taxpayers to be left holding the bag. And when you recommend that the National Flood Insurance Program get out of the business of being a flood insurance provider and do its transition, I don't think I saw anywhere in there where you addressed what happens to the $23 billion in debt. Did I miss that? Or is there something there that you can share with us?

Mr. BIRNBAUM. No. The short answer to your question is that the same thing is going to happen, would happen, as is going to happen right now, which is taxpayers are on the hook for the $23 billion. Right now, there is this belief that somehow the NFIP is going to generate funds into the future sufficient to pay back that $23 billion. Given that you are continuing to allow or require the NFIP to subsidize rates—and, with H.R. 2901, you are going to put the NFIP in a position of being even more financially vulnerable—you are not only never going to pay back the $23 billion through the NFIP, you are going to create an even larger requirement for the NFIP to borrow from Treasury. So the answer to the question is that $23 billion is there; cut your losses and move to a system of sustainability.

Mrs. BEATTY. When you say, "cut your losses," that makes it go away?

Mr. BIRNBAUM. It doesn't make it go away. But Congress is going to have to pay that $23 billion because there is no way that the NFIP is going to be able to repay back over time, even under the current requirements, let alone under the requirements of H.R. 2901.

Mrs. BEATTY. So I guess what I am hearing—and certainly you are the expert—is that if Congress is going to have to pay it for it to be privatized, and Congress is going to have to pay it to leave it the way it is, where is the in-between of public and private in sharing in that cost?

Mr. BIRNBAUM. By moving to flood as part of the standard homeowners and commercial property insurance, what happens then is that the Federal Government stops being on the hook for flood insurance losses. It means that the private market is responsible for accepting the exposures, pricing them appropriately, and paying the claims. The bleeding stops. And that is what is necessary at this point in time. So you accomplish several things by putting it with the private market along the proposal we have made. You not only stop the hemorrhaging of Federal money, number one. But, number two, you get better pricing, you get more comprehensive coverage, and you get better opportunities for loss mitigation. You get private insurers now incentivized to get involved in loss mitigation for flood in a way that they currently have no interest in doing right now.

Mrs. BEATTY. For the sake of time, I am going to move on quickly to you, Mr. Bradshaw. Can you tell me the value of the flood plain maps as it benefits lower- and middle-income Americans and first-time home buyers?

Mr. BRADSHAW. Certainly the value of the flood plain maps are significantly improved today as compared to when I started in the business in 1971, when we received this big box roll of maps and our objective was or our assignment was to locate all of the properties on the map. So the digitization of the maps helped to improve significantly, we believe, the underwriting of the flood insurance risk.

All that being said, there are several places with the mapping that are incorrect and that the private market will be able to identify those from using different approaches. And then the hope is that provides more choices, that provides more opportunities for our consumers to afford the flood insurance, particularly the lower income and the new home buyer.

Mrs. BEATTY. Okay.

Thank you.

Mr. ROSS. Thank you.

The gentlelady's time has expired.

I now recognize myself for 5 minutes.

Ms. Miller, you spoke in your testimony about some of the obstacles of Biggert-Waters that are preventing you from being able to authorize private flood insurance in the State of Pennsylvania. Are you seeing an influx of interest from the private market to want to write to flood insurance in Pennsylvania?

Ms. MILLER. Mr. Chairman, we are not seeing an influx of interest. It is still a very limited market. We are seeing some increased interest. We are seeing more surplus lines policies. But it is still a very limited market.

Mr. ROSS. And if H.R. 2901 were to pass, do you think that would change things and allow for the presentation of more private capital to come in and take the risk in Pennsylvania?

Ms. MILLER. That is my hope. That is why I am here supporting it because I would like to see the private market grow. And I would like to see consumers have more options.

Mr. ROSS. And if the private market does grow and they are assessing the risk based on their models and based on what they believe is appropriate in risk-based analysis, do you feel that there may also be an opportunity then that these private carriers may not only offer flood but also want to include it in an all-perils since they have—managing the risk?

Ms. MILLER. I think that is right.

Mr. ROSS. And would that not lead to an opportunity where we may have even more people, assuming other Insurance Commissioners across the country feel as you do, to include more people to want to participate in flood insurance because the private carrier can offer it to them at a lower price?

Ms. MILLER. That is the hope.

Mr. ROSS. And would that not lead to an opportunity, as Mr. Birnbaum says, where you would see more and more policies include in their all-perils flood? But to keep it the way it is now where we bifurcate NFIP against an all-perils policy is not going to help the situation. Would you agree?

Ms. MILLER. Yes.

Mr. ROSS. I have enjoyed listening to Mr. Birnbaum. I agree with him. And I think you will too that—when he states in his testi-

mony, “consumer protections provided by the States are far greater than those that exist for NFIP insurance,” would you agree?

Ms. MILLER. Yes.

Mr. ROSS. And have you had any problems, well, let me put it this way, do you feel comfortable continuing to allow surplus lines carriers to write flood insurance in the State of Pennsylvania?

Ms. MILLER. Absolutely.

Mr. ROSS. Thank you.

Mr. Kelly, surplus lines, they just don’t just write flood insurance, do they?

Mr. KELLEY. They just don’t write flood insurance. I appreciate that question. We have heard here that surplus lines are not regulated. We have heard that they are not licensed. That is—

Mr. ROSS. Correct. And if you would discuss those.

Mr. KELLEY. —simply incorrect. Every surplus lines insurer is licensed in a State. It may not be licensed in every State. But in order to be eligible to write surplus lines insurance, as Commissioner Miller described, you have to be licensed in your State of domicile. So the regulation of that insurer from a financial solvency, from a market conduct perspective, none of that varies between the standard market and the surplus lines market.

Mr. ROSS. And surplus lines are currently writing flood insurance policies now?

Mr. KELLEY. Absolutely. And here is why, not just because of the Biggert-Waters Act, but because for decades, you have had consumers whose problems weren’t solved by the limits of the NFIP or who didn’t have a standard market option.

Mr. ROSS. So under the law, surplus lines carriers can write policies? And is the number of policies growing over time in flood insurance? I doubt it is significantly. But is it growing?

Mr. KELLEY. It is not significant. You have seen the stats in my testimony. And I will just recap them here. We have about six States, some of the biggest States, that capture flood insurance data. And those 6 States, which represent about 50 percent of our surplus lines market, wrote $134.1 million in flood premium in 2014.

Mr. ROSS. And then because my time is limited, would H.R. 2901 assist and facilitate in the increase of policies available and being purchased by consumers for flood?

Mr. KELLEY. Yes, it would.

Mr. ROSS. Thank you.

We talked about mitigation yesterday. And I think the overall goal of a flood insurance policy, as in any insurance policy, is to have the minimization of risk with the benefit of an affordable policy because if you don’t focus on that, then what you are providing is nothing but relief. And relief is not where we want to go because that creates FEMA and then that creates greater problems without any control. So what benefit is there in making sure that we allow for incentives to mitigate the risk? And what benefit is being provided or incentives being provided right now by NFIP for that mitigation? Would anybody like to take a stab at that?

Mr. BIRNBAUM. Sure. So the key incentive for loss mitigation is proper pricing of the insurance product.

Mr. ROSS. Correct, Mr. Birnbaum. And I apologize because you are on something I want to talk about, and I only have a couple of seconds. Would not the consumers benefit greater for having more assessment of risk done in a granular fashion if the private carriers were involved to make sure that they are protecting their investment on that risk to the benefit of the consumers so that we would have a more affordable market with less risk of loss to the consumer?

Mr. BIRNBAUM. The answer to that is, yes, if it were comprehensively done by the private market. If you do just selective with the cherry-picking of H.R. 2901, then you have some consumers who get that and the majority of consumers don't.

Mr. ROSS. My time is running out.

Clearly, then, I would suggest that H.R. 2901 offers that transition to create the NFIP to be the market of last resort, which I think is what the panelists would like to see in the overall equation.

Thank you. My time has expired.

I now recognize Mr. Rothfus from Pennsylvania for 5 minutes.

Mr. ROTHFUS. Thank you.

Ms. Miller, I am going to talk a little bit about the surplus lines insurers. You mentioned in your testimony that there is a growing appetite in the surplus lines market to provide private flood insurance coverage and that Pennsylvania has had some success with surplus lines carriers offering flood insurance. Taking a national perspective, do you feel comfortable with surplus lines carriers writing private flood policies?

Ms. MILLER. Congressman, I do.

And, in fact, in Pennsylvania, one of the things we are trying to do as a department right now is figure out how we can do a better job of letting consumers know that this option exists. That is now comfortable I am with surplus lines policies.

Mr. ROTHFUS. Can you talk a little bit about the regulation of the surplus lines insurers? How do State insurance regulators monitor the financial health of surplus lines insurers?

Ms. MILLER. Absolutely. As Mr. Kelley indicated, surplus lines carriers are licensed in the State of their domicile. So in that State, they are meeting the capital and surplus requirements that the admitted carriers are meeting. And so even though we talked about earlier the fact that the guaranty fund doesn't apply to surplus lines, there is financial monitoring of surplus lines carriers. And even in nondomiciliary States, there are capital and surplus requirements on surplus lines carriers, as well as carriers who are not domiciled in the United States. So I am comfortable we have a lot of financial regulation protection. But also we have, in a State like Pennsylvania, if we have a surplus lines carrier that is not domiciled in Pennsylvania, we still have authority over the placement of that insurance with the surplus lines broker and the opportunity to go after that broker if there is misconduct. But we also have I think—

Mr. ROTHFUS. What kind of misconduct are you talking about?

Ms. MILLER. For example, in Pennsylvania, we have a requirement that they notify policyholders that, for example, the guaranty fund doesn't apply if they misrepresent the policy somehow. Or if

they place the policy with a non-admitted or a non-eligible surplus lines carrier, we can go after that broker.

Mr. ROTHFUS. These are basic consumer protection items that you are talking about?

Ms. MILLER. Exactly. We also enforce the requirements related to the eligibility of surplus lines carriers to operate and sell policies in our State. So if we have concerns about the financial soundness of a surplus lines carrier, if they are not paying claims timely or if they are willfully violating our laws, we can declare them ineligible to sell policies in our State. Additionally, in Pennsylvania, we have what is called the Unfair Insurance Practices Act. I think States have similar laws that are probably titled a little bit differently. And these, again, are consumer protection statutes. They make sure that claims are paid appropriately and that the insurer and the broker are not misrepresenting policies and what is covered. And this Act applies to surplus lines carriers just like it applies to admitted carriers.

Mr. ROTHFUS. Great.

Mr. Birnbaum, you expressed concerns in your written testimony about the level of regulation and policyholder protection for surplus lines that are not admitted insurers. In fact, on page 21 of your testimony, you state that Ross-Murphy "sets the table for more problems for consumers who have purchased the surplus lines policies when and if that occurs." I would point out that Commissioner Miller, from my home State, reports at least 5 surplus lines carriers have sold flood insurance in Pennsylvania, writing around 1,000 policies, and that the State closely monitors surplus lines business. What evidence do you have to show that State Insurance Commissioners or State regulators have not protected consumers, particularly with policies sold through non-admitted carriers via surplus lines?

Mr. BIRNBAUM. Sure. So with admitted carriers—

Mr. ROTHFUS. What evidence? I am looking for what evidence that you have where you can show me where this has been an issue.

Mr. BIRNBAUM. The evidence is that regulators don't have authority to approve forms or rates. Commissioner Miller in the last few weeks has issued a bulletin on price optimization, telling insurers that they can't use a consumer's willingness to pay to determine the price that they charge the consumer. She has no authority to do the same thing for surplus line insurers. And it is the same thing with rate issues and other policy form issues. A surplus lines insurer could include a provision in the policy—

Mr. ROTHFUS. You are saying, "could, could, could." I am looking for specific examples where it has actually happened. What evidence? That is what I am looking for from you.

Mr. BIRNBAUM. The evidence—I will give you evidence from the force-placed insurance market. The largest writers of private flood insurance today are force-placed flood insurers. And the largest of those are admitted carriers. So private flood insurance can be written by an admitted carrier. But there have been issues where those private flood insurers, when they were using surplus lines, were charging exorbitant rates that were far in excess of the reasonable cost of providing insurance. So that has been reined in, in part be-

cause the Federal Housing Finance Authority and some State regulators have said: You need to move that force-placed flood from surplus lines to the admitted market.

Mr. ROTHFUS. But State regulators would have the authority to go after them. Would State regulators have the authority under existing—

Mr. BIRNBAUM. They have authority basically for financial condition. But they don't have the same authority as they do over admitted carriers for things like policy forms and rates. If there is such great consumer protection in the surplus lines, why doesn't Pennsylvania or every other State allow all personal auto and all homeowners to be written in the surplus lines market? Why do they require that to be written in the admitted market? Because there are more consumer protections in those markets.

Mr. ROTHFUS. Ms. Miller, would you care to respond to that?

Ms. MILLER. Sure. So surplus lines, the way it works is surplus lines are for unique risks. That is why we have admitted carriers that write the rest of personal lines policies because we have laws in all the States about diligent search requirements. And if you can buy a policy through the admitted market, then that is what you do. Really, surplus lines are for those unique risks that aren't being written by the admitted market.

Mr. ROTHFUS. I yield back, Mr. Chairman.

Mr. ROSS. The gentleman's time has expired.

The Chair recognizes the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. I thank Mr. Ross for his leadership on trying to tackle this complex issue.

Mr. Murphy, I thank you as well for your efforts in trying to deal with what is clearly a very complicated issue and a huge potential liability for the taxpayers and an affordability issue, frankly, for a lot of my constituents in rural central and eastern Kentucky. I appreciate what H.R. 2901 is trying to do in terms of clarifying that State insurance regulators have the authority to regulate private flood insurance, clarifying the definition of private flood insurance. But I want to have Ms. Miller, Mr. Bradshaw—Mr. Kelley actually address a point that Mr. Birnbaum is making, which I think is a pretty interesting and good point. And that is that there is this impediment to private insurance offering flood coverage based on just the simple fact that they have to compete with the subsidized rates of the NFIP. Even if H.R. 2901 does move us in the right direction in these areas, what do we do about this fundamental problem, about the competition with subsidized rates?

Ms. MILLER. I think that is a challenge. And I think in terms of the future of NFIP, at the NAIC, we will be embarking this year— I know the reauthorization is coming up next year. And it sounds like there is a lot of interest in talking about ways we can modify that program. We have not had conversations at NAIC yet about potential recommendations for changes to that program. But it was just announced that I am Chair of the Property and Casualty NAIC Committee. And I can tell you that this is on our agenda for this year. We are going to be looking at this and putting together kind of our recommendations for ways that perhaps NFIP could be modified going forward. From my perspective today, I am here be-

cause I just want to see consumers have more options. And I believe H.R. 2901 will provide for more private market options for folks. And I think that will be a good thing for consumers.

Mr. BARR. Mr. Bradshaw?

Mr. BRADSHAW. With regards to the affordability of the program, however this comes out, is that we are very interested in making sure that the consumers can afford the product. We believe that competition will bear that true. We have a unique position in Louisiana where we have such a high concentration of flood risk, very much of it is required. Many of our customers are required to have flood insurance. So the impact by NFIP and a huge change in the premium not only affects our consumers but the property values, which we have a high level of interest in because at the end of the day, we are the guys who are protecting the investors. So we are very interested in that. We would see it that it is somewhat like the relationship with FHA in the general market of lenders and of guarantors in the mortgage business is that FHA has a role. Looking back to the late 1980s of the oil bust, FHA was the only program in town. So the NFIP does serve a significant and a long-term benefit.

Mr. BARR. Thank you.

And as we move to Mr. Kelley, Mr. Kelley, if you could answer just two specific questions as we—in response to Mr. Birnbaum's testimony. In your view, as an advocate of H.R. 2901, what is preferable about Ross-Murphy to the TRIA model that Mr. Birnbaum is advocating? What is preferable to the surplus lines solution to the TRIA model that Mr. Birnbaum is advocating? And, secondly, could you respond to Mr. Birnbaum's contention that H.R. 2901 would give surplus lines insurers the ability to cherry-pick NFIP policies that are overpriced and low risk, making the NFIP more financially vulnerable? I am really interested to hear your thoughts on that.

Mr. KELLEY. Thank you for that question. With respect to the TRIA model concept, H.R. 2901 does a very different job of pushing this coverage to the private market. TRIA mandated that the private market offer terrorism coverage. This is giving the private market the opportunity to get in and figure it out, invest in underwriting processes, and get the experience to develop products. Many standard companies, I think over time, will probably add flood to the standard homeowners policy like we have talked about here. It is just going to take time. I think it will happen. It is just going to take time. And much of that experience will transpire out of what the surplus lines market is able to do.

What was the second question?

Mr. BARR. The issue of cherry-picking.

Mr. KELLEY. The issue of cherry-picking, the issues you are trying to balance here are affordability, availability, and financial stability of flood insurance. Terms like "cherry-picking" and "adverse selection" obviously have very negative bias when referring to private companies and their business decisions based on sound financial models, actuarial data, capacity, risk appetite, and experience. The private market's financial stability is in all of our, especially the consumer's, best interest. Making decisions about the types of risk to write, regions to write in, capacity to allocate to those re-

gions, those are essential elements to maintaining a solvent, viable marketplace. So regardless of which risk you transfer from the public to private balance sheet, it starts to transfer some of them and reduces the long-term exposure to the subsidized Federal Government.

Mr. BARR. Thank you.

I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we will go to the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And I thank all of the witnesses for your participation today.

Mr. Birnbaum, you heard I am from Texas. In your testimony, you specifically state that private insurers can offer flood insurance and can do so more efficiently and effectively than the NFIP. I am going to agree with you 100 percent on that. And I believe the Federal Government has gotten way over its head on this issue like it does with a lot of things.

But you also state that H.R. 2901, of which I am a cosponsor and proud to be one, will not address the longer term problems with the NFIP, will not promote private market participation in the sale of flood insurance, will create bigger problems in the future when flood events occur, and will eliminate State regulatory oversight. So three questions. Number one, how can H.R. 2901 totally eliminate State regulatory oversight?

Mr. BIRNBAUM. Okay. H.R. 2901 removes from Biggert-Waters the limitation that private flood insurance can be written by surplus lines for commercial policies. It opens the door to surplus lines for residential flood insurance. By doing so, it means that private flood insurance basically moves out of the admitted market where there are far more consumer protections than in the surplus lines market. So, that is the basis for that assertion.

Mr. WILLIAMS. Number two, what is your assessment of the State regulatory system in light of your statement on page 19, meaning do you have a lack of faith in the State regulatory process?

Mr. BIRNBAUM. No. I am a strong supporter of State-based regulation. It hasn't been an unqualified success over the years. But I am a strong supporter of it. And I demonstrate that strong support by saying that flood, by being part of the standard homeowners and commercial property insurance, then becomes the responsibility of State insurance regulators. What H.R. 2901 does is it creates this, continues this Rube Goldberg apparatus of constricting the NFIP, giving them all sorts of requirements and constraints, giving the private, the State-based regulators certain responsibilities. But the overall thing makes no sense. If you want to get to a sustainable future, then you utilize the private market but give them the full responsibility overseen by State-based regulation. Don't include this NFIP that is required to provide sort of subsidized insurance, which gives the private sector then the opportunity to say: Well, we are only going to take this most profitable business; we are going to leave the more risky and the less profitable business to the Federal Government.

So you are privatizing profit and socializing the risk. That is exactly the thing that is outraging people all over the country. It is

the type of crony capitalism that basically says: Look, we are going to give one group of people the government advantage, instead of trying to create a level playing field for everyone.

Mr. WILLIAMS. How would the State regulation of flood insurance differ from the State regulatory process for homeowners insurance or other insurance lines?

Mr. BIRNBAUM. Right now, for surplus lines, what Commissioner Miller and others have said is they regulate the financial condition of the surplus lines insurer, and they have some ability to regulate sort of marketplace misconduct.

But they don't have the ability to ensure that policy forms are not misleading or deceptive. They don't have the ability to ensure that rates are not unfairly discriminatory. And, more important, they don't have the ability to make sure that the NFIP meets its goals. So you have Federal requirements for flood insurance, and you are essentially delegating part of the responsibility for insuring that to the State-based regulators.

And while I am a big supporter of State-based regulation, there have been some notable failures. If we look at private mortgage insurers, we saw that in the financial collapse, private mortgage insurers failed. Those were under the purview of State-based insurance regulators. So we are not talking about a pristine record here.

But I have faith in State-based insurance regulation if you give them the comprehensive tools to do it, not the piecemeal approach of H.R. 2901.

Mr. WILLIAMS. I am a private-sector guy. I am in the retail business. And I can tell you, in the counties I represent in Texas, we have had a lot of flood problems, and the way to get it right is turn it over to the private sector. Let the private sector compete. Let the consumer drive the industry, not the Federal Government. And I think you will see prices will be right, and service will be better.

And I am happy to be on H.R. 2901.

Mr. Chairman, I yield back my time.

Chairman LUETKEMEYER. The gentleman yields back.

With that, the gentlelady from New York, Ms. Velazquez, is recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

I am sorry I wasn't here to listen to your testimony, but I was in a markup in the Small Business Committee. We just finished. But I want to thank you all for being here.

And I have just one question, to Mr. Bradshaw.

My district in New York City, which encompasses communities on New York City's Lower East Side and Red Hook, was especially hard hit by Superstorm Sandy.

In a January 2014 report published by the GAO, some stakeholders noted that the rate increases associated with private-sector flood insurance could lower a home's market value. Some stakeholders also expressed concern that whole communities with a high risk of flooding, like those in my district, could become economically unviable if the increase in premium rates makes flood insurance unaffordable for too many residents.

Mr. Bradshaw, how do we ensure premium rates on flood insurance do not rise to such a level that it causes homeownership rates to decline, particularly in vulnerable communities?

Mr. BRADSHAW. Certainly, we have had some similar experiences with Hurricane Katrina, and our part of the country and the Gulf Coast is very much at risk, just as you, and, certainly, taking nothing away from the flooding that has taken place on the Mississippi River in Missouri right now, as well. People are in harm's way.

We look to committees such as this to make sure that those folks who need help in order to maintain their property values, in order to continue to make a living, to continue to have access to homeownership—and that, from that perspective, there seems to me to be a parallel between what FHA does in the home mortgage business and what NFIP does for the flood business.

In our part of the country, Port Fourchon is one example, which carries 25 to 35 percent of the petrochemical business from the Gulf up to the mainland. There are reasons that has to be there. People have to work there. So that very well may require some subsidization of premiums for people in that area. It is very important.

I am not sure that I know how to do that. I know that what we have right now has created $23 billion in debt and that if we fail to plan for the next event, if there is an event, then we will merely re-experience what we have today.

So we are very eager to help protect the consumer. We are very eager to be very interested and verbal to help protect the consumer. Because without them, our business goes away.

Ms. VELAZQUEZ. Thank you.

Chairman LUETKEMEYER. The gentlelady yields back.

I now recognize the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you very much, Mr. Chairman.

And I thank the witnesses.

And, of course, I always thank the ranking member for her leadership on these issues.

I lived through Katrina. And it is inappropriate to say I lived through it because I wasn't actually there—

[Phone rings.]

Mr. GREEN. Excuse me. This may be the President calling.

I wasn't actually there.

It is not the President. Okay. So, I won't take the call.

I wasn't actually there. But I arrived shortly thereafter, and I saw the tragedy that was left behind. I went to Sri Lanka after the tsunami. I was in the Philippines after Haiyan. And I know what this looks like, the aftermath, and it is not a pleasant sight, to say the very least. And I am being quite euphemistic.

Here is the question that I have for you, dear friends: Are you indicating that, if we had this system in place pursuant to H.R. 2901, that we would not have expended the billions of dollars that we had to expend after Katrina, that this would eliminate the necessity for the Federal Government to step in? This is an important question for me and my constituents.

Yes, sir, if you would?

Mr. BIRNBAUM. So the answer to that is H.R. 2901 would not have prevented any of the problems that you just described, because H.R. 2901 would continue to leave the NFIP with those policies in high-risk areas, it would continue to have the NFIP charg-

ing inadequate rates, it would continue to have subsidies for people who don't need them.

So you would still have the same problem you would today. And, as a matter of fact, it would be worse, because the NFIP, instead of broadly averaging its rates and getting revenue for policies in lower-risk areas, it wouldn't even have had that revenue. So the situation would be worse today if H.R. 2901 had been in place.

If our proposal of having the private sector provide the flood insurance, then the $23 billion would not be there today if our system had been in place.

Mr. GREEN. On the question of the billions that we currently find ourselves indebted to, I suppose the Treasury, would we still have that $23 billion debt if we had H.R. 2901 in place?

Mr. BIRNBAUM. Well, yes. The $23 billion is not going to go away under the existing situation. And it is certainly not going to go away under H.R. 2901. It is going to get worse under H.R. 2901.

Because the private sector is going to take the most profitable of the policies—remember, I told you earlier that the NFIP puts things into 30 risk categories, with 1 being the lowest risk, and 30 being the highest, and then averages that. The private sector is going to come in and take 1 through 14, leaving the NFIP with 15 through 30, the most risk. So the NFIP is going to have almost the same risk but much less revenue. So the situation is going to get worse for the NFIP. It is going to let the private sector cherry-pick the most profitable policies that are out there.

What is needed is to give the private sector the responsibility to handle the entire problem, which is price all of the policies. There is always going to be an issue with affordability, right? There is just no way around it. But you can't have affordability addressed through the insurance pricing system. When you underprice insurance, you create incentives for people to invest badly. You invest in areas where it is not sustainable. It is critical to have risk-based pricing.

It is also critical to have financial assistance delivered in the form of loss mitigation. Instead of giving people a grant to pay for the insurance, give them money to mitigate their homes so that they are less exposed to flood. Reduce the cost of flood insurance by reducing the exposure. That is where the target of Federal expenditure should be. The delivery of the insurance should be in the private sector.

Mr. GREEN. Thank you.

I will yield back the balance of my time.

Chairman LUETKEMEYER. The gentleman yields back.

With that, I recognize the gentleman from Florida, Mr. Murphy, for 5 minutes.

Mr. MURPHY. Thank you, Mr. Chairman, and thank you, Ranking Member Cleaver, for today's hearing.

And Ranking Member Waters, thank you for your leadership on this.

And, Mr. Ross, who has now left, I thank him as well for his cooperation, working in a bipartisan manner to make some progress here.

And I very much appreciate the input of all the panelists today, the witnesses, for this important discussion, hearing all your comments, all your thoughts.

The bottom line is, how can we provide more affordable flood insurance options for people all across the country? This legislation that we are discussing, the Flood Insurance Market Parity and Modernization Act, which I have sponsored with my good friend and fellow Floridian, Mr. Ross, aims to do just that.

This Act would provide more choice, greater competition, and less cost in the flood insurance market. It would accelerate the development of more flood insurance options by allowing policies accepted by the State to satisfy mandatory coverage requirements under the NFIP.

Now, when Congress passed the National Flood Insurance Act, its intention was that insurance companies would provide flood insurance coverage for the American people. And when the legislation that was recently updated under the Biggert-Waters Flood Insurance Reform Act of 2012, that intention was, in fact, reaffirmed.

However, due to the, I would say, lack of legal clarity on the particulars of the insurance policies allowed into the program, most lenders have not accepted private flood insurance to meet mandatory coverage requirements.

This bill would solve this problem by providing a simple and clear definition of private flood insurance accepted for the mandatory coverage under the program, consistent with the successful regulation of other forms of insurance in the marketplace—that which is issued by an insurance company licensed, admitted, or otherwise approved to engage in the business of insurance in the State in which the property is located.

I believe there will always be a need for the NFIP, but there is more than enough flood risk out there that can be written right now by the private insurers that are willing to do so, whose capability will only continue to advance with the growth of new technology and modeling.

Ensuring access to private flood insurance choices will help reduce the risks to which taxpayers are exposed under the Federal program. And especially because flood insurance coverage is mandatory in many areas, customers need more competition and options in the flood market to make it more affordable.

So I ask that my colleagues on both sides of the aisle support this legislation to give our people, our constituents more choice, greater competition, and ultimately less costs when it comes to flood insurance.

I came to Congress, as did most of us here, to work with everyone, no matter what the party affiliation, and to solve problems. I think this legislation is one example of an area we can actually make some progress in this last year of this Administration, and I urge my colleagues to do so.

In my remaining time, a question for Mr. Kelley: One topic of discussion that we had in this conversation, writing this legislation dealt with surplus lines and their role in this. Approximately how many surplus lines, if you know off the top of your head, flood insurance policies, in Florida have been accepted for the purposes of NFIP mandatory purchase?

Mr. KELLEY. I have the Florida data here somewhere. I have it combined with six States, actually.

In 2014, $134.1 million worth of flood insurance premium written in those six big States: Florida, California, Texas, New York. $32.9 million of that, 24 percent of that, covers residential property. And of that category, only about 29 percent represents primary coverage, the balance being excess coverage on a personal residence.

So it is still a relatively small share of the overall surplus lines market. It is less than 1 percent of the $40 billion market nationwide.

Mr. MURPHY. Okay.

Mr. Birnbaum, in your opinion, how does this differ from homeowners insurance? Both seem to be intended for the same thing, where that is protecting the loan in an event of a disaster. How do you see the difference?

Mr. BIRNBAUM. I don't. That is why our proposal is to require that the homeowners insurance policy cover the peril of flood. That would deliver that coverage far more efficiently than through the requirement of a second policy. It would mean that everybody gets the coverage that they expect and pay their fair share for that coverage than under the current system.

And private flood is already being provided by the admitted market to a greater extent than the surplus lines market. As I mentioned earlier, force-placed flood—there is more force-placed flood written by admitted carriers than the surplus lines numbers that Mr. Kelley described.

So it is not as if it is unfeasible for admitted carriers to write flood. It is feasible. The question is, what is the best way to nudge the private market into this? And, in my view, the best way is to require the coverage of flood in those homeowners and commercial property policies, because that accomplishes a variety of things, including problems with the NFIP as well as fairness issues and promoting loss mitigation.

The problem with H.R. 2901 is it addresses a very narrow issue but can create problems in other areas of the flood program.

Mr. MURPHY. Thank you.

Chairman LUETKEMEYER. The gentleman's time has expired.

We are going to go for a second round. I think everybody has maybe just one or two questions, so it shouldn't be too long. We do have votes coming up here shortly.

So, with that, we will go to the gentleman from Kentucky, Mr. Barr. You are recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

Just to follow up on an issue, there is a pretty good consensus here that we need to incentivize more private participation in flood insurance, obviously. But beyond the Ross-Murphy approach to bring in more surplus lines, companies that write NFIP policies currently have to sign this noncompete clause, which pushes these companies to the sidelines in terms of developing and offering private flood insurance policies.

For any of the witnesses who are interested in this, would you support language in H.R. 2901 or other legislation that would eliminate this noncompete clause that is currently required by FEMA?

Mr. BIRNBAUM. The answer to the question is, you can't eliminate the noncompete clause without doing anything else. Because if you eliminate the noncompete clause, then you have a situation where the company is selling policies for FEMA and also selling its own flood policies.

So what the company will do is it will make its evaluation of what the riskiest policies are and give those to FEMA, and keep the most profitable ones or the least risky ones. So what you have is essentially adverse selection. So there is a reason why there is a noncompete clause.

That is an example of, well, we will try to address one narrow issue without looking at the broader problem. You really need a comprehensive approach. And the comprehensive approach is the private market provides flood as part of the residential and commercial property insurance, subject to the standard State-based regulation; the NFIP transforms to a catastrophic reinsurer role.

And that enables all of the players to participate—private markets, the State-based regulators, alternative capital. And it puts the Federal Government in a role of focusing on loss mitigation, which is the long-term solution to addressing flood problems.

Mr. BARR. I would love Mr. Kelley to respond. But it seems like, in advocating the TRIA model, you are avoiding this adverse selection, cherry-picking issue, but you still have a Federal backstop in either model. And I am just wondering which is the better model?

Mr. Kelley, do you want to weigh in on that?

Mr. KELLEY. Just to respond to the write-your-own prohibition, I agree with your point, Congressman. I think that is one barrier that we are seeing to the standard market stepping in. If they are already involved in the write-your-own program, they can't offer their own standalone program.

We haven't taken an association position on that. That has not been an issue we have really focused on. But it clearly is a barrier that I think would get more standard carriers involved if it weren't there.

Mr. BARR. Ms. Miller, do you have any thoughts?

Ms. MILLER. Congressman, we also are in the same position. The NAIC hasn't taken a look at this issue. I think it is one of the issues that, as we look at the NFIP and potential recommendations we would make to modify that program, this would be one of the things we would look at.

But I do think it is a very interesting issue to look at. I think, from our perspective, H.R. 2901 would be a great first step. And if we could do that quickly, then I think having the conversation about changes to NFIP would make a lot of sense, as well.

Mr. BARR. Let me just follow up with one final question. Mr. Birnbaum is making the argument that the Ross-Murphy bill would actually exacerbate the financial solvency problems of the NFIP.

I think we all agree that we don't want to get the NFIP in more financial distress than it already is. So, as advocates of the Ross-Murphy approach, do any of you all—Ms. Miller, Mr. Bradshaw, Mr. Kelley—want to address that issue?

Ms. MILLER. I would be happy to.

I think the issue of cherry-picking is certainly a concern and something that we would recommend monitoring going forward.

But, right now, as I have said a few times, this market is very small. There is just too little data, I think, at this point, to know how the market is going to react going forward. So, from our perspective, if this bill were enacted sooner rather than later, I think it would give us a chance to get more data and really observe how this market is going to perform going forward.

And I think that does a couple of things. I think, one, it gives us—and all of us who are going to be looking at the NFIP, it will give us more information to inform potential changes to that program. But, also, from a State regulators perspective, I think if we had more data, it will help us as we look forward and think about ways we might need to change our regulation to address this evolving market.

But I think, from our perspective, I certainly wouldn't want concerns about cherry-picking to get in the way of us providing more options for consumers in this market.

Mr. BARR. Mr. Kelley?

Mr. KELLEY. And I think back to that 1-percent category of properties. We have to admit, no one is lining up to write those right away. And the thought of actually adding those types of coverages, add a flood peril to that general homeowners policy, that is going to price them out of their home, in our opinion.

So if we can focus on at least shifting some of the burden out of the Program, you at least reduce the overall risk. That leaves you with, then, the category of the highest-risk properties that perhaps a residual market is there to figure out. And it, in our mind, would allow the NFIP then to focus on what do you do about mitigating that risk, what do you do about preventing flood damage in those areas.

Mr. BIRNBAUM. I just need to jump in quickly and say it is absolutely crystal clear that this bill would allow surplus lines and encourage surplus lines insurers to cherry-pick. It is as obvious as the nose on your face. The only policies that the surplus lines writers would do are the ones that they view as profitable.

The NFIP has a variety of policies, ranging from less profitable to more profitable, and what will happen is they will be left with the less profitable policies, the highest-risk policies, and less revenue to do it.

There is no question this bill will lead to greater financial problems for the NFIP. And I am really surprised that the other panelists are not acknowledging that.

Mr. BARR. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we will go to the ranking member, the gentleman from Missouri, Mr. Cleaver, for some follow-ups.

Mr. CLEAVER. Thank you, Mr. Chairman. And, again, before we close out, I want to thank you for the vision of trying to get this done much earlier than we normally try to get critical legislation through.

I just have one question. My son is in school outside of Los Angeles, and I go out and I see all of these houses built on cliffs. That's like saying, "I dare you to rain and wash my house down the cliff."

And because I am on this subcommittee, I am always angry, driving through there, and saying little words as I drive.

But those are usually wealthy people. The chairman and I and Ms. Waters, we were in the Ninth Ward just a few months ago, and Ranking Member Waters and I were there just a few weeks after Katrina. I had a son in college down there at the time. And it was just decimated. And the actor from Missouri, Brad Pitt, raised a lot of money, and they rebuilt the Ninth Ward. Most of the houses are now on stilts. But the people are still there. And these are not rich people; these are poor people. That ward was and still remains a low-income ward, although the people go to work every day.

So would any of you believe that it is practical to expect that poor residents, low-income residents, could actually pay the full risk rate for private insurance? Or do they get left out?

Mr. BIRNBAUM. The answer to that is they can't pay the full risk rate if there is no loss mitigation. If they are in a high-risk area and they are paying the full risk rate, then, no, they are not going to be able to afford it. But they wouldn't be able to afford a surplus lines policy either.

But the question is then, where do you want to spend your Federal dollars? Do you spend your Federal dollars to subsidize that policy, or do you spend your Federal dollars on loss mitigation that reduces the exposure for that homeowner and thereby reduces the premium?

If you just simply subsidize the rate, then you set the table for future claims, repetitive claims. If you spend the Federal dollars instead as an investment in loss mitigation, then you reduce that exposure, reduce the claims down the road, you reduce the disaster relief.

So the model has to be: Let's spend Federal dollars on loss mitigation as a way to make the insurance more affordable instead of subsidizing the rates. That is not a long-term solution. Subsidy is not a long-term solution. Loss mitigation investments are.

Mr. CLEAVER. Yes, that would be a FEMA issue and not necessarily one that we would have to deal with, the mitigation issue.

Mr. BIRNBAUM. They go together, Congressman. You can't tell the NFIP to offer subsidized rates and then say, invest in loss mitigation.

Mr. CLEAVER. They do in the real world. But this isn't the real world. I would like for it to be, but that is just not the way it is. I understand exactly what you are saying, and I agree with what you are saying, if we were in the real world.

Mr. BIRNBAUM. You have the power to create that real world.

Mr. CLEAVER. Thank you.

Mr. Bradshaw?

Mr. BRADSHAW. Just very quickly, as you know, Congressman, there has been a huge investment in the levee system in New Orleans, which we appreciate significantly. There was a huge modernization of the levee system in New Orleans. So when you live behind a dam, you have to be always conscious and always vigilant if the dam starts leaking.

So the National Flood Insurance Program is a very important program in order to help those folks who do need help to maintain affordable housing. We are very much in favor of that.

Mr. CLEAVER. Thank you.

Thank you, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman yields back.

With that, I have just a couple of follow-ups.

Mr. Kelley, during the course of the discussion, you indicated that we have 1 percent of the policyholders who create 30 percent of the loss. Mr. Birnbaum has been talking about those guys and how do you adequately rate those folks, how do you fund them, how do you not fund them. His suggestion is you, through mitigation, take that 1 percent and reduce it down as much as you can, I guess.

So my question is, do you believe—because today we are talking about how we can shift from what we have now to a more private market solution. Do you believe that if you take that 1 percent out, the other 99 percent of the policies can actuarially be structured so that those 99 percent can afford the coverage and take care of that other 70 percent of the risk?

Mr. KELLEY. I wish I could answer that question. I am not the actuary in the room. I think there is a large percent of it that you can. What percentage, I can't quote you.

Chairman LUETKEMEYER. Because it would seem to me that would be a key point. Because if you have 1 percent causing 30 percent of the problems, that is the group that is causing your headaches. That is where your risk is. So if you can take the other 70 percent of the risk and divide it among the 99 percent of the policyholders, you would appear to me to be able to find a way to fund this that would be affordable.

So my next question would be, as someone who represents the industry and sees opportunity, how long do you think it would take for the market to transition from where we are to where they would be willing to take this 99 percent of the policyholder risk on?

Mr. KELLEY. Let me start by saying it is going to take that transition to figure out how much of the 99 percent can transition. But that is going to take some time—

Chairman LUETKEMEYER. We have a transition period, but how long do you think it would take?

Number one, is there a willingness within your companies and the capacity to take this on in a 2-year, 5-year, 10-year, 20-year window? What would you anticipate being something that would be reasonable for the companies to be able to do their due diligence, get their mapping correct, get their modeling correct so that they could see where they could come in, make it a part of the homeowners policy, as Mr. Birnbaum suggested, which I, quite frankly, like? How long do you think it would take?

Because one of the concerns that we have as a committee is, if we are going to try to go from here to there, we need to have an idea time-wise. And the testimony today is very important to us to be able to do that. And I am not going to hold you to it, but it certainly gives us a guideline to begin discussions.

Mr. KELLEY. I would say that there is capacity already there. As the Commissioner already testified, most of what we are seeing transition out of NFIP is to surplus lines carriers now. So there is capital there. There is a lot of capital in surplus lines.

But, long term, our model—we wouldn't expect that business would stay in surplus lines for a very long time. Many types of coverages evolve out of surplus lines into the standard market. That is how the model works. That is how the market should work.

Chairman LUETKEMEYER. What you are saying is eventually it would go into Mr. Birnbaum's model of being a part of the homeowners policy itself?

Mr. KELLEY. I think you are. Eventually, as the standard market does their own investment in technology and modeling and expertise with the risk, I think you will see many of them start to add that peril to their standard homeowners policies. It is that time between now and then that our market acts as the residual market.

Chairman LUETKEMEYER. Okay. Thank you.

Let me yield to the gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. GARRETT. Thank you. And I won't use the whole time.

I thank the panel. We have been following some of your testimony back in the office. So just to play off of your points, I guess I will throw it out to Mr. Kelley, and I know it is in some sense putting you on the spot as trying to be the actuary in the room. And what do they say about actuaries? Those are the people who found being a CPA was just too exciting? Something like that.

So, in any event, the question that you posited is what? If you did it what a 1 percent, 99 percent, what would the situation look like, and your answer was that you couldn't exactly say for sure. But I am guessing that if you did it that way, that for the 99 percent—and anybody else can chime in on this—it would be a more favorable rating structure for them than it is right now, right?

So, in New Jersey, if I am in, I am not, but if I am in that 99 percent right now after the last go-around with the maps and what have you, I am seeing my rates go so high that I am having to sell my place, is what—not me, but the people back in Jersey are finding that. If you went to this 1 to 99 situation, theoretically my premiums might be more reasonable. Do you want to—

Mr. BIRNBAUM. Yes, I don't think so.

Mr. GARRETT. Mr. Birnbaum, too.

Mr. BIRNBAUM. I don't think that—

Mr. GARRETT. Is that true or not?

Mr. BIRNBAUM. Here are the facts. There are 5.2 million NIFP policies, and there is well over a million that are subsidized. And the exact number isn't known because there are a bunch of policies that not only are Pre-FIRM subsidized but also grandfathered—

Mr. GARRETT. Right.

Mr. BIRNBAUM. —subsidized.

Mr. GARRETT. Good point.

Mr. BIRNBAUM. So you are talking about 20 to who-knows-what percent of the policies are subsidized. So to suggest that if we take out the 1 percent somehow that all of a sudden it has become affordable for the 20 or the 30 percent where it is currently subsidized, that is just not going to happen.

So you cannot create affordability strictly through the insurance pricing mechanism.

Mr. GARRETT. So—

Mr. BIRNBAUM. There is always going to be a situation where some consumers can't afford a risk-based price. And you need some assistance from outside the system. We don't—for example—

Mr. GARRETT. That gets to the second point of the question. Because I get that, but then perhaps some of those people are living in areas that maybe are just not a risky or an overly risky place to be. And that has to be taken into consideration as well.

Does anyone think that there would be a difference if you go to that direction, either 100 percent or 1 to 99 percent, as far as the mitigation? And I heard some of the talk before as the necessity for mitigation, would there be a change in the mitigation processes on the private sector versus the public way that we do it right now?

Mr. BIRNBAUM. Oh, absolutely, Congressman. If—

Mr. GARRETT. For the better?

Mr. BIRNBAUM. Yes. If the private sector were responsible for flood insurance as part of the homeowners policy, they would have an incentive for loss mitigation that they simply don't have right now.

Mr. GARRETT. Okay.

Mr. BIRNBAUM. So you would see things like partnerships for loss mitigation. You might see multiyear homeowners policies where the loss mitigation is financed with a loan that is paid for from the discounts.

Mr. GARRETT. Okay.

Mr. BIRNBAUM. There are opportunities for innovation that simply aren't going to occur by saying, let's hope the private sector gets involved if the surplus lines puts its toes in the water.

Mr. GARRETT. With that, I am going to yield back. I see I am over time.

Chairman LUETKEMEYER. Mr. Bradshaw would like to respond.

Mr. GARRETT. Oh, sure.

Chairman LUETKEMEYER. Go ahead.

Mr. BRADSHAW. Just a really quick response. Of course we now experience 5 percent named storm deductibles in hazard insurance in our particular marketplace. And so we continue to have that risk. And as a lender then we accept part of that risk. And that is typically what we are seeing unless you buy down to a 2 percent named storm.

Now, that is not flood insurance, but that is the hazard insurance. And there is not much loss mitigation on hurricanes.

Mr. GARRETT. I thank the Chair.

Chairman LUETKEMEYER. Just as a follow-up comment to Mr. Birnbaum's point, I think if you wind up with the private insurers trying to figure out what to do with the 1 percent and say you can incentivize that group for mitigation by saying if you do these things, we will drop your premium, and therefore you can have an impact in that way, I believe, as well.

So, it is a fantastic and a fascinating conversation we have had this morning. And I certainly want to thank all of the witnesses. You have answered a lot of the questions that we have had. You have given us a lot of food for thought. You have kind of broadened our scope of what we are trying to find here and trying to look to do.

Trying to see once how we restructure the program, what we can do, what the private sector is willing to do, how different innovations can be a part of this. Regulatory-wise how this can be overseen to make sure that the consumers are protected yet there is adequate provisions in policies that—to provide coverages that are real and meaningful. So, I thank all of you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, the hearing is adjourned.

[Whereupon, at 11:26 a.m., the hearing was adjourned.]

A P P E N D I X

January 13, 2016

Testimony of Birny Birnbaum
Executive Director
Center for Economic Justice

Before the

Subcommittee on Housing and Insurance
Committee on Financial Services
United States House of Representatives

"How to Create a More Robust and Private Flood Insurance Market Place"

January 13, 2016

Birny Birnbaum Testimony before the House Financial Services Committee
How to Create a More Robust and Private Flood Insurance Market Place"
January 13, 2015

Chairman Leutkemeyer, Ranking Member Cleaver and Members of the Subcommittee, my name is Birny Birnbaum. I am the Executive Director of the Center for Economic Justice, a non-profit consumer organization that advocates on behalf of consumers on financial service issues, with particular emphasis on the availability and affordability of essential insurance products. Thank you for the invitation to speak before the Subcommittee in today's hearing. The availability and affordability of flood insurance is a critical issue for individual and community well-being, economic development and a resilient and sustainable future. I have worked on these issues for over 20 years as an insurance regulator, consulting economist and consumer advocate.

Your invitation to testify asks whether the National Flood Insurance Program (NFIP), as it is presently constituted, represents an ideal model for the effective protection of residential and commercial property owners from damages related to flooding.

The answer to that question is a resounding no for a number of reasons. The primary problem of the NFIP is the multiple and conflicting goals that Congress has tasked the program with and the constraints and requirements Congress has placed on the program. The NFIP has been tasked, in whole or in part, with:

- Providing insurance coverage to individual homeowners and business for the peril of flood as an alternative to disaster relief;
- Promoting the sale of flood insurance with broadly-subsidized rates;
- Removing subsidies and moving to risk-based or "actuarial" pricing;
- Addressing repetitive claims for properties in high-risk areas;
- Addressing problems of affordability of flood insurance
- Identifying and mapping flood risk through an interactive process with local governments;
- Paying back past flood insurance losses that greatly exceeded revenues collected; and
- Promoting flood loss mitigation and prevention

With such varied and conflicting responsibilities and limitations, it is not surprising that the NFIP has been a poor flood insurance program.

The very first step for Congress to address problems with the NFIP is to clarify not only the role of the NFIP, but the goals for federal expenditures in the area of flood loss mitigation and disaster relief. The starting point for Congress and the federal government should be that the goal of federal expenditures for disaster relief and loss mitigation related to flood is to promote more resilient and sustainable homes, businesses, communities and infrastructure against the peril of flood. With this as the clear goal, then any proposals regarding the NFIP can be evaluated by asking – does this change promote resiliency and sustainability or not?

The reason why resiliency and sustainability must be the overarching goal and guiding principle for restructuring the NFIP is that there is no insurance mechanism – public, private or public-private – that will be able to finance increasingly frequent and severe flooding. Stated differently, the only long-term solution to flooding is massive investment in flood loss mitigation. Such loss mitigation accomplishes three critical things –

1. Reduces the loss of life and property from flooding events;
2. Creates greater potential for insurance to cover the more manageable remaining flood risks; and
3. Reduces government expenditures on disaster relief in the future.

Loss mitigation and flood insurance are the essential foundation for individual, business, community and national economic security, economic development and national security. Investments in loss mitigation coupled with flood insurance mean that flood events cause less damage than in the absence of the mitigation and, when flooding does occur, more of the damage is insured. Lesser damage with flood insurance coverage means much quicker recovery by individual and businesses from the catastrophic event. From the perspective of a taxpayer looking at federal expenditures, those expenditures become far more than disaster relief, but are investments in resiliency and sustainability which mean fewer federal expenditures in the future for disaster relief that would otherwise be required.

Step 1 is Congressional clarity on the role of the NFIP and the Federal Government in flood prevention and flood disaster relief – and that role is to view federal expenditures as investments in resiliency and sustainability. Matched against this goal and operating principle, the current structure of the NFIP fails. The problems include

Relatively few homeowners and businesses purchasing flood insurance and consequently relying on disaster relief or savings to recover from flooding events.

The NFIP currently over 5.2 million policies in force[1] but many consumers in Special Flood Hazard Areas (SFHA – areas designated by FEMA as at higher risk of flooding) don't purchase flood insurance. The NFIP states that only 23.3% of homes in SFHAs have flood insurance. And even though many flood events occur outside of SFHAs, an even smaller percentage of consumers outside of SFHAs purchase flood insurance.

The absence of insurance for flood damage reduces the resiliency of homeowners and businesses. In its second report on flood insurance affordability, the National Academy of Sciences Committee on the Affordability of National Flood Insurance Program Premiums wrote:[2]

> A resilient community is one which has the capacity to "absorb change and disturbances," returning quickly to full function. One test of community resiliency is its ability to recover from a major flood.
>
> The disruptions most relevant to NFIP flood insurance are direct damages to property and its contents. Following a flood, property owners bear the responsibility for repair or replacement of damaged buildings. Residential structures may be damaged or destroyed, relocating population and disrupting community cohesion. In some cases, property owners may have the financial resources—either available funds or borrowing capacity—to move quickly to restore properties to pre-flood conditions. However, many if not most property owners are not in a position to finance major, unanticipated repairs, let alone complete reconstruction. The other means of dealing with flood damage are:
>
> - Abandon the property, either in full or in part;
> - Use post-flood disaster assistance (in the form of grants or low-interest loans) and other funds as needed to make needed repairs or replacements; or
> - In the case of properties covered by flood insurance, use insurance proceeds and other funds as needed to make needed repairs or replacements.
>
> The first option is, of course, the antithesis of resiliency. If this is the result for some number of properties throughout a community, then the structure and the function of the community are lost or, at best, seriously damaged.

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[1] NFIP Presentation at PCI Flood Conference, 2015. http://www.pciaa.net/docs/default-source/default-document-library/tom-and-andy-show-wednesday-9-30am-salons-5-6.pdf?sfvrsn=2

[2] Affordability of National Flood Insurance Program Premiums -- Report 2 (hereafter "NAS Affordability Report 2") at page 31

> For any significant damage, it would appear that the property owner must bear the bulk of the financial responsibility. Clearly some may be unable to do so. Insurance can thus be resiliency enhancing in that it can make the funds needed for rebuilding available to disaster victims. In summary, reliance on disaster aid seems likely to produce only partial recovery and that only after some delay. For both reasons, some community resiliency is lost.
>
> Communities with high takeup rates can be expected to be more resilient than those, which rely on self-funding and government assistance. High takeup rates will be associated with not only more complete recovery of community structure and function, but also more timely recovery.

Improper price signals to individuals and businesses making investment decisions about property purchases.

Many NFIP policyholders – over a million, but the exact number is unknown – are presented a flood insurance premium that is less than cost of insuring the property – subsidized rates. The subsidized rates arise from several rating practices of the NFIP, some of which are required by Congress and some of which are not. Congress has mandated that some pre-Flood Insurance Rate Map (pre-FIRM) pay less than the risk-based premium. Congress has also mandated that certain properties are "grandfathered" at certain rates even if the information or environment has changed such that the risk-based rate would be higher for these properties. The NFIP calculates the aggregate amount of the subsidy for grandfathering, divides this amount by the number of non-Grandfathered policies and adds that amount to the non-grandfathered policies. Finally, the NFIP evaluates flood risk in SFHAs by dividing the properties into 30 groups ranging from lowest to highest risk. The NFIP then uses the average expected claim costs for all 30 zones for the claim cost, and subsequent premium, for properties in any of the 30 zones.

The NFIP rates would not meet state insurance regulation requirements that rates be not excessive, not inadequate and not unfairly discriminatory. Commissioner Kevin McCarty of the Florida Office of Insurance Regulation, in a letter to Florida State Senator Jeff Brandes wrote:

> Without data and further analysis though, we can say that the rates are unfairly discriminatory. NFIP has developed its rating based on multiple zones that are combined to determine rates, with 30 different A zones and separately 30 different V zones. Those zones are defined based on a theoretical determination of the probability of flooding (the V zones are more coastal). These are averaged together to charge one rate across the country. The averaging together of zones with different costs and charging one rate would be considered unfairly discriminatory from an actuarial perspective which would not pass scrutiny under Florida law.

Substantial subsidies within insurance rates – meaning substantial deviation from cost – based or risk-based pricing – means that consumers and businesses considering an investment in real property are not facing the proper price signals regarding the cost of maintaining and protecting that property. The result is that properties are built (and purchased) in areas of significant flood risk, but that risk is hidden by inadequate flood insurance prices. And when Congress tries to move away from those subsidies, many homeowners face the untenable situation of not being able to afford the risk-priced flood insurance or sell their now-devalued home.

Inadequate incentives for loss mitigation due to subsidized rates;

Subsidized rates not only encourage real property investments in areas of great flood risk, but also reduce the incentives for loss mitigation investments. If the cost of effective loss mitigation is, say $10,000, a consumer facing a subsidized $500 flood insurance premium faces a different cost –benefit analysis than a consumer facing a risk-based $2,500 premium.

In this example, the first consumer will very likely not make the mitigation investment, meaning that the property is less resilient than it could be and the NFIP is more likely to pay claims or government is more likely to pay some form of disaster relief. With the second consumer, the $10,000 investment reduces the NFIP premium to $500, but the more resilient home now poses less risk for the NFIP and government and, most important, is far less susceptible to damage from a flood event.

Federal expenditures for disaster relief that leave individuals and communities more susceptible to future loss instead of more resilient and sustainable.

FEMA has worked hard to promote loss mitigation to prevent damage from flood events, recognizing that federal dollars spent on disaster relief which do not strengthen and fortify structures and infrastructure will not reduce federal expenditures on disaster relief for future events. But the pricing practices of the NFIP undermine FEMA's and our nation's efforts at building a more resilient and sustainable building stock and economy. Federal dollars spent on flood insurance subsidies encourage the kind of development that is more susceptible to damage from flood events. Instead of federal expenditures as investments in resiliency and sustainability, the federal expenditures on NFIP flood premium subsidies make increased future federal expenditures for disaster relief more likely.

Subsidies for consumers who do not need financial assistance and lack of or inadequate government assistance for those who do need financial assistance to purchase flood insurance or invest in flood mitigation.

The current system of subsidies within the NFIP flood insurance rates is the worst possible way to provide financial assistance to those consumers who cannot afford flood insurance because the broad-based subsidies go to policyholders regardless of their ability to afford the flood insurance premium. From an economic perspective, it is highly inefficient and, from an equity perspective, it is hugely unfair to provide subsidies to consumers who could and would pay their fair share.

In addition, the subsidies are so broad that there is no guaranty that even the subsidized price is affordable for many consumers. Stated differently, the NFIP subsidies don't take into account individual policyholder ability to pay, so there is no clear link between the subsidized flood premium and more consumers purchasing flood insurance. Subsidies are likely going to many who don't need the subsidy, while the subsidies are likely insufficient for others.

Subsidies by some taxpayers of other taxpayers in the offer of and cost to deliver flood protection.

The NFIP has argued in public forums that taxpayers are not subsidizing the NFIP and will not do so unless and until Congress forgives the $24 billion NFIP debt to the Treasury Department. Putting aside the fact that the NFIP has repaid little of the debt incurred for Katrina and later flood events, the fact is that the NFIP is also not establishing reserves as required by Congress. The current NFIP structure not only causes some NFIP policyholders to subsidize other NFIP policyholders, but causes taxpayers in some states to subsidize flood insurance purchased by taxpayers in other states.

Inefficient delivery of coverage for flood with additional administrative costs for private insurers to sell the NFIP policy separate from the standard residential or commercial property insurance policy.

The NFIP policy is a standalone flood insurance policy which a homeowner or business must purchase in addition to the residential or commercial property insurance covering fire and perils. This is a very inefficient approach to delivering flood insurance protection for several reasons. First, the requirement of a consumer to purchase a separate policy in addition to the homeowners policy is an impediment to the purchase of flood insurance. Second, the NFIP policy includes its own administrative, sales and claim settlement costs. The NFIP utilizes private insurers to sell and administer the NFIP policies and pays them a significant portion of the premium to do so – 15% of premium for agent commission for sales and 12% of premium for WYO operating expenses. The GAO, in one of its many reports on the NFIP, questioned whether the payments to WYO insurers are reasonable in comparison to services provided.[3]

> However, the reasonableness of FEMA's compensation to WYOs is unclear. As we found in 2009, FEMA does not systematically consider actual flood insurance expense information when it determines the amount it pays WYOs for selling and servicing flood insurance policies and adjusting claims. Rather, since the inception of the WYO program, FEMA has used various proxies for determining the rates at which it pays the WYOs. Consequently, FEMA does not have the information it needs to determine (1) whether its payments are reasonable and (2) the amount of profit to the WYOs that is included in its

[3] April 9, 2014 Letter from GAO to Representative Neugebauer, "Overview of GAO's Past Work on the National Flood Insurance Program," at page 14.

> payments. As part of our 2009 report, we compared expense payments FEMA made to six WYOs to the WYOs' actual expenses for calendar years 2005 through 2007. We found that the payments exceeded actual expenses by $327.1 million, or 16.5 percent of total payments made. We concluded that opportunities existed for FEMA to improve its oversight of the WYO program and ensure that payments to the participating insurance companies were based on actual company expenses, thereby improving the program's cost-effectiveness.

Third, the use of the NFIP of WYO insurers to settle NFIP claims creates a conflict of interest for the WYO insurer because the insurer is tasked with determining whether the claim is covered under the homeowners policy (which the WYO insurer would pay) or a flood claim excluded from the homeowners policy and covered by the NFIP (which the WYO insurer would not pay.) This arrangement led to major claim settlement disputes between consumers and private insurers following Hurricane Katrina. At best, the arrangement is inefficient because in many cases the cause of damage is unclear between wind and water.

Lack of standard insurance consumer protections found in state regulation of residential and commercial property insurance.

The state-based insurance regulatory system is over 150 years old and has a long record of overseeing insurance companies that sell property insurance, the policy forms and rates these companies use, the advertising and disclosures and sales practices of the insurers and their agents and the claims settlement practices of the insurers. A great body of insurance law, regulation and market regulation practice has developed for these property insurance products. While consumer advocates like my organization believe the state-based system can be significantly improved, the consumer protections provided the states are far greater than those that exist for NFIP insurance. The NFIP is outside of state insurance oversight with the result that activities like NFIP claim settlement do not have the same consumer protections as homeowners insurance claims.

Lack of a residual market for flood insurance, leaving force-placed flood insurance as the de facto residual market.

The vast majority of states have what is known as a "residual market insurer" for those consumers unable to find insurers willing to sell property insurance to the consumer. These residual markets, often called FAIR plans, are state-based insurers or insurance mechanisms that serve as insurers of last resort for consumers unable to find insurance is the "voluntary" market. In some states and during some periods, the residual market has grown very large as private insurers have retreated – as was the case in Florida where the insurer of last resort, the state-run Florida Citizens, grew to become the largest insurer in the state. Residual markets are an important consumer protection because they provide insurance when the voluntary market is unwilling to do so.

There is no residual market for flood insurance – the NFIP is both the primary insurer and market of last resort. While the NFIP will rarely refuse to issue an insurance policy, many consumers who are required to have flood insurance fail to purchase the NFIP policy or other voluntary flood policy. The result is that, if these consumers have a mortgage, the mortgage lender/servicer will force-place flood insurance and charge the homeowner for the force-placed coverage. Force-placed flood is effectively the residual market for flood insurance, but the coverage is not comprehensive (no coverage for personal property/contents or additional living expense) and is very expensive due to the reverse competitive nature of force-placed insurance markets.

Private property insurer and state residual market coverage of flood is not a panacea for force-placed flood insurance, since the lenders/servicers often have a financial interest in force-placing insurance. But, a residual market alternative could help.

Why Don't Private Insurers Write Flood Insurance?

Some private insurers do write flood insurance. Insurers selling force-placed insurance offer force-placed flood coverage as well as force-placed hazard for residential and commercial properties. Much of the force –placed flood is written through admitted insurance companies while some is written by surplus lines insurers. Auto insurers also cover damage to vehicles from flood.

Notwithstanding these examples of private insurers offering flood coverage, insurers who sell residential and commercial property insurance typically exclude flood as a covered peril. Why don't these insurers provide flood coverage? The short answer is they don't have to. The substantive reasons insurers offered over 40 years ago are no longer compelling – lack of information to evaluate flood risk and inability to spread risk concentrated in flood zones. Today, insurers have or could obtain information to evaluate flood risk and have the ability to spread risk by including flood coverage in all policies. However, excluding a low-frequency, high-severity peril – that means that flooding doesn't happen often, but can cause massive damage when it does – is a long-standing practice of insurers to manage risk and, particularly important for publicly-held insurers, a way to ensure smooth earnings for investors.

Other impediments to private insurers offering flood coverage have been competing with subsidized rates of the NFIP, lack of reliable data on flood risk and lack of reinsurance. The situation, however, has changed. Most importantly, there are now much greater and better data on flood risk. Catastrophe modelers produce flood models, just as they produce the hurricane and wildfire catastrophe models used by insurers. There is also much more information available about building structure and elevation to go along with enhanced data on flood risk. And, although over a million NFIP policyholders received subsidized rates, there are millions of NFIP policyholders who now pay more than risk-based rates a private insurer would charge.

There has been more interest recently by surplus lines insurers to sell flood insurance policies in competition with the NFIP. Surplus lines or nonadmitted insurers can be distinguished from admitted insurers in the following ways.

Admitted insurers are licensed by a state insurance department to sell certain types of insurance in the state. These insurers are subject to regulatory requirements for filing and approval of policy forms (the insurance contract) and rates, are subject to the state's consumer protection laws regarding unfair trade practices and unfair competition and participate in the state guaranty fund system (which pays claims in the event the admitted insurer becomes insolvent). The state guaranty fund system is a critical part of the state policyholder protection framework.

In contrast, surplus lines insurers are not licensed by state insurance departments. Rather, the state insurance departments regulate surplus line agents who are authorized to place coverage with a surplus lines insurer on a list of acceptable insurers. Surplus lines policy forms and rates are not subject to regulatory oversight and surplus lines insurers do not participate in state guaranty funds.

Most states have a requirement that a surplus lines agent cannot place coverage with a surplus line insurer if that coverage is available in the admitted market. One common requirement is for a surplus lines agent to seek coverage from two or three admitted carriers and document the declinations before placing the coverage with a surplus lines insurer.

The Way Forward

As an economist who has studied insurance markets for over 20 years, I understand the power of market forces to promote efficient delivery of essential financial products to consumers. I also understand and have seen how government can effectively intervene in insurance markets when those markets are not competitive. In many instances, regulatory intervention in insurance markets promotes more competitive markets by empowering consumers and setting a level playing field among insurers. And in some instances, private markets are unwilling or unable to provide necessary insurance products. However, flood insurance is not one of those products – private insurers can offer flood insurance and can do so more efficiently and effectively than the NFIP. Stated differently, there is a long-established state-based insurance regulatory system that has overseen property insurance for 150 years and this state-based system of largely private insurers can and should offer property insurance covering the peril of flood.

Relying on the state-based insurance regulatory system to oversee the delivery of property insurance coverage for flood insurance by private insurers is the best way for Congress to move federal government expenditures and activities towards investments in resiliency and sustainability related to flood risk. There are four key actions needed by 2017 to get private insurers in the business of providing flood insurance and to get the federal government out of that business and, instead, focused on flood risk mitigation.

1. Get the NFIP out of the business of being a flood insurance company by requiring that residential and commercial property insurance policies sold by private insurers (and some state residual market insurers) cover the peril of flood. This requirement turns flood insurance back to the states – where all other property insurance products and markets are regulated – and back to private insurers, reinsurers and catastrophe modelers, who have the capability and capital to provide flood coverage more comprehensively and efficiently than the Federal government.

2. Transition the NFIP from a direct provider of insurance to a mega-catastrophe reinsurer, utilizing the successful model of Terrorism Risk Insurance Program

3. Address the affordability problem of flood insurance with federal, state and local assistance outside of the insurance system – no subsidies in insurance pricing – with an overwhelming emphasis on assistance for loss mitigation as the tool to create more affordable premiums.

4. Reauthorize the NFIP to continue sale of flood insurance during a finite transition period to coverage of flood risk in residential and commercial property insurance policies sold by private insurers and state residual markets, overseen by state insurance regulators.

Benefits of Requiring Coverage for Flood as Part of Residential and Commercial Property Insurance Policies

There are a number of benefits to requiring the peril of flood be included in residential and commercial property insurance policies currently sold by private insurers (and some state residual market insurers). These benefits include:

1. ***More efficient and lower-cost delivery of flood coverage than through a separate NFIP policy.*** By adding flood to the other covered perils in existing property insurance policies, private insurers can deliver that coverage with less administrative and claim settlement cost than the NFIP. As discussed above, the NFIP pays a significant portion of NFIP policy premium to WYO insurers as commission and operating expense and the NFIP incurs its own expenses for

issuing and administering policies. Including flood in existing property insurance policies will eliminate a significant portion of the administrative expense not only because the costs of a second policy are eliminated, but because the remaining administrative costs will be subject to competitive market forces instead of WYO insurers simply taking close to 30% of the NFIP premium with no relation to costs incurred by these insurers.

A second and equally important efficiency would be in claims settlement. Instead of the NFIP paying a WYO insurer to determine whether a loss was the result of wind covered by the WYO's policy or flood covered by the NFIP policy, an insurer settling a claim for a property insurance policy which covers flood will simply settle the claim. Instead of multiple parties involved in the claim settlement process, it will be the private insurer who sold the policy subject to a long-established state-based regulatory system of consumer protections for insurance claims settlement practices.

2. ***Accurate prices to consumers and businesses making investment decisions on the purchase of real property.*** By including flood in property insurance policies overseen by state insurance regulators, the prices for insurance will be subject to cost-based pricing requirements – rates must not be excessive, inadequate or unfairly discriminatory. Accurate risk-based pricing is essential to enable consumers and businesses to make informed decisions about the true cost of purchasing and maintaining the property purchased. In addition to other problems, subsidized rates don't do consumers or businesses a favor because they mask the true cost of the property and leave the consumer or business in an untenable position when the subsidy is removed.

3. ***Cost- or Risk-Based Prices provide the proper economic signals for investments in loss mitigation.*** With subsidized rates, cost-effective investments in loss mitigation do not appear cost-effective. Cost-based prices are essential for greater investments in flood risk mitigation.

4. ***Unleash the expertise of private insurers, reinsurers and catastrophe modelers on flood risk identification and mitigation.*** United States' property insurers have had little involvement in flood risk mitigation efforts because they have little or no "skin in the game." This is in sharp contrast to property insurers in other developed countries who actively and aggressively partner

with government to promote and implement flood risk mitigation strategies. In 1968, when Congress passed the National Flood Insurance Act, it may have been the case that private insurers did not have the capability to insure flood risk. That is not the case today. The property casualty industry is very well capitalized, reinsurers are eager to cover flood risk, alternative capital (catastrophe bonds and insurance-linked securities) now exists and catastrophe modelers are fully capable of modeling flood risk as they do for hurricane, wildfire and other perils. Moreover, these private market participants are better capable of keeping flood maps current to changing flood risk – information essential for proper insurance pricing and for maximizing loss mitigation investments.

5. ***Private sector incentives for flood risk mitigation.*** For decades, a private insurance advisory organization has performed fire safety ratings for communities around the country, ranking the capabilities of communities and their fire departments on fire safety and fire response. These fire safety ratings are a factor in property insurance rates and provide incentives for communities to invest in fire protection since these investments result in lower property insurance rates for community members. By moving flood insurance out of the NFIP to private insurers, this same type of private sector community flood risk rating could provide the same beneficial results as fire safety rating.

6. ***All consumers and businesses will have coverage they expect and pay their fair share for that coverage.*** Under the current law, only certain properties in certain areas are required to have flood insurance with the result that far too many consumers and businesses are uninsured for flood risk. Flooding events over the past ten years, in particular, show that flood occurs in areas other than those designated as Special Flood Hazard Areas. By requiring flood be part of property insurance coverage, flood risk will be provided to all with the result that consumers and businesses will not be surprised to discover their property insurance policies exclude the coverage they expected.

In addition, the pricing of flood insurance protection can be more equitable and transparent. It would be more equitable because consumers and businesses in very low risk areas will pay very little – but they will pay something to reflect the small risk. Consumers and

businesses in high-risk areas would be charged more for flood insurance coverage – providing better price signals on the cost of maintaining the real property and the cost-effectiveness of mitigation investments. Affordability issues will remain, but those issues will be addressed not by skewed pricing in the insurance system, but by means-tested assistance, discussed below. Cost-based pricing by private insurers – with required disclosure to policyholders – is more transparent and fair than the current system of hidden subsidies by some NFIP policyholders of other NFIP policyholders and by some taxpayers of others.

7. ***Promote more resilient consumers, businesses and communities.*** By having far more flood insurance in place, consumers, businesses and communities will be better able to quickly recover from damage caused by flooding events.

8. ***Promote a larger, more diversified risk pool.*** With flood as part of property insurance policies, private insurers can diversify flood risk across multiple perils and across the entire country. This greater risk diversification means greater ability and willingness of reinsurers and alternative capital to support primary insurers.

<u>Transition the NFIP from Direct Insurer to Mega-Catastrophe Reinsurer</u>

One aspect of flood risk that holds back private insurers is the low-frequency, very high severity of flood events. This means that flooding events don't happen very often – compared with auto collisions or house fires, for example – but when floods do occur, the damage (and insured loss if flood is a covered peril) can be huge. While insurers can and do handle catastrophe risk by diversifying across multiple perils and broad geographic distribution of policies and by purchasing reinsurance and other forms of catastrophe protection like catastrophe bonds, the potential for a flood event causing massive damage does deter private insurers from insuring flood risk. To address this concern and to promote private market sale of flood insurance, Congress should transform the NFIP from a direct provider of insurance to a reinsurer for mega-catastrophic flood events – the same model as the successful Terrorism Risk Insurance Program (TRIP). TRIP is a federal program that provides reinsurance for mega terrorist events with the federal government's responsibility beginning only after private insurers have incurred a certain level of claims/losses from a terrorist event.

A federal flood reinsurance program should have even higher trigger points – the level of losses at which the federal reinsurance steps in – than TRIP because reinsurers and alternative capital seem far more interested and willing to provide coverage for flood than for terrorism. It is essential that the trigger for federal reinsurance payments not be too low and crowd out willing reinsurers and alternative capital. In addition and unlike the TRIP, the NFIP as a mega-catastrophe flood reinsurer should charge a fee or premium for the reinsurance provided.

Address Affordability Issues Outside of Insurance Pricing With Overwhelming Emphasis on Loss Mitigation to Reduce Financial Burden

There is and will be a need for financial assistance to some consumers who cannot afford the cost of flood insurance coverage as the price of that coverage moves to the risk-based price. By requiring flood coverage as part of property insurance policies sold by private insurers and state residual markets, the cost of that coverage should be significantly less than it would be for a risk-priced NFIP policy because of the efficiencies of including flood in an existing policy instead of selling a second policy. But, the risk-based cost of flood coverage will still be greater than present for some consumers and unaffordable for many.

There is a need for financial assistance to those who cannot afford flood insurance. That financial assistance must be governed by four operating principles:

1. ***Financial assistance should be provided only to those who do not have the income or wealth to afford the required insurance.*** Taxpayers paying for government expenditures should not be asked to subsidize insurance for those who have the income and wealth to afford the required insurance.
2. ***Financial assistance should not be provided through distortion of insurance prices by subsidized rates.*** As discussed above, cost-based pricing is essential for moving towards more resilient and sustainable homes, business and communities.
3. ***Financial assistance should overwhelmingly be provided through grants and loans for loss mitigation as a way to lower insurance premiums.*** The key role of government at all levels should be to partner with insurers, homeowners and businesses to invest in loss mitigation as the key path to building more resilient and sustainable structures and to reduce government spending on disaster relief in the future. Financial assistance for loss

mitigation which reduces the insurance premium because of lower risk of loss should be emphasized over grants or payments to insurers to cover the cost of insurance premiums because such payments have a similar impact as subsidizing rates – distortion of the price of insurance and the cost of protecting and maintaining real property.

4. ***Financial assistance should be a partnership between government, insurers and policyholders.*** The involvement of insurers is essential because it is the discounts for loss mitigation efforts which effectively finance the loss mitigation and because insurers are in the position of facilitating loss mitigation financing by, for example, offering multi-year policies which might match the term of a loss mitigation loan.

Reauthorize the NFIP to continue sale of flood insurance during a finite transition period

The NFIP comes up for reauthorization in 2017. More time is needed to transition the sale of flood insurance from the NFIP to private insurers offering flood coverage as part of standard residential and commercial property coverages. I estimate that three years will be needed once Congress establishes the requirements of our flood insurance proposal. If, by 2017, Congress passed and the President signed the required legislation, the NFIP would need to be reauthorized until 2020 during the transition period to private market responsibility for flood insurance protection. States would need to clarify and establish requirements for flood coverage in residential and commercial property insurance policies and insurers would need to file policy forms and develop rates reflecting the flood risk. Reinsurers and catastrophe modelers would need to develop their flood-related products. And, most important, FEMA, or whichever agency Congress determines should be responsible, needs to develop the programs and partnerships for identifying consumers in need of financial assistance and delivering the assistance is a variety of ways, including partnerships with state and local governments and insurers.

Comments on H.R. 2901, the Flood Insurance Market Parity and Modernization Act

As we have seen over the past decade, the Congressional changes to the NFIP has lurched from efforts at longer-term reform to responses to current crises – with the responses to current crises often contributing to bigger problems down the road. H.R. 2091 is a response to a current issue – federal agencies have been slow in promulgating rules regarding private flood insurance and surplus lines insurers see an opportunity to pick off NFIP policies that are mispriced or overpriced due to the NFIP rating practices.

H.R. 2091 will not address the longer-term problems of the NFIP, will not meaningfully promote private market participation in the sale of flood insurance and will create bigger problems in the future when flood events occur. In addition, the legislation effectively tasks state insurance regulators with oversight of the federal requirement for flood insurance, but removes the key requirement in current law that the insurance be subject to standard state-based insurance regulatory requirements.

H.R. 2091 adds an option for lower coverage amounts. Instead of the minimum coverage amount for certain NFIP policies being the lesser of replacement cost or NFIP maximum coverage amount, the legislation makes the minimum coverage the lesser of unpaid principal balance, replacement cost or the NFIP maximum coverage amount. First, it is unclear that lenders will lower their requirements for coverage in response to this change. Lenders routinely require more than the minimum required flood coverage and have force-placed flood insurance for the difference between the NFIP coverage amount and the coverage amount required by the lender/servicer.[4]. Federal agencies and the United States are on record arguing that the coverage requirements of 42 USC 4012a(a) are minimums and not ceilings on coverage amounts that lenders may require.[5]

More important, the "benefit" of a lower premium today will be long forgotten when a flooding event occurs and the homeowner has inadequate coverage to repair her home.

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[4] For example, see "Adding Insult to Injury: Lenders force homeowners into costliest flood coverage," Syracuse.com, May 13, 2012 at http://www.syracuse.com/news/index.ssf/2012/05/adding_insult_to_insurance_len.html

[5] See "Brief for the United States as Amicus Curiae" in No 11-2030 United States First Court of Appeals, Kolbe v BAC Home Loans Servicing, et al.

If the homeowner is unable to afford the insurance premium for the needed replacement coverage, then he or she is unlikely to be able to afford the large out of pocket to make up the difference between repair costs and insurance proceeds. This is an example of a short term fix creating a longer-term problem because the inadequate insurance coverage means, at best, inadequate repairs leaving the home more susceptible to future damage and, at worse, the homeowner losing the home. It is inconsistent with the primary goal of promoting greater resiliency and sustainability.

H.R. 2091 attempts to encourage private market provision of flood insurance by eliminating state regulatory oversight of private residential flood insurance by defining "private flood insurance" to include surplus lines insurers and also by eliminating federal oversight by removing the current consumer protection requirements for private flood insurance, the authority and responsibility of federal agencies to implement those requirements in a regulation and the authority of the Government Sponsored Enterprises (GSEs) to establish standards for the claims paying ability of insurers providing flood insurance on mortgages the GSEs own or insure.

The result of these changes is to facilitate the sale of private flood insurance by surplus lines insurers. I understand that the logic behind this approach is that admitted insurers are not willing to write private flood insurance, but surplus lines insurers would be if requirements – such as comparability with the NFIP policy or claim settlement requirements – were relaxed. The story continues that once surplus lines insurers are offering private flood insurance, admitted insurers will become more comfortable with selling private flood and proceed to do so. I have seen no empirical evidence to remotely suggest admitted insurers will do as suggested. I am not aware of a personal lines insurance product or coverage which migrated from surplus lines to admitted carriers because of market forces. I have seen surplus lines insurers write business that admitted insurers would have written and I have seen personal lines business migrate from the admitted market to surplus lines when permitted to do so.

The actual result of these changes will be for surplus lines insurers to cherry-pick NFIP policies that are currently overpriced due to the NFIP's broad rating scheme and loadings for contingency and reserves. Earlier I explained how the NFIP evaluates flood risk across 30 risk groups within a SFHA with group 1 being the highest elevation relative to Basic Flood Elevation and group 30 being lowest (and, consequently most exposed to damage from a flood event). The

NFIP does not charge different rates for each of the 30 groups, but averages the expected claim costs across all groups in the SFHA. The surplus lines insurers will cherry-pick the policies in the risk groups below the overall average, leaving the NFIP with the policies in the above-average risk groups. While the surplus lines insurers take the profitable, lower-risk policies, the NFIP will become even more financially vulnerable as its premium revenue will decline more than its risk exposure. While the states have an interest in affordable insurance for residents, the states don't have an interest in ensuring sufficient revenue for the NFIP.

In addition to creating larger problems for the NFIP in the future, the legislation sets the table for more problems for consumers who purchase the surplus lines policies when an event occurs. As discussed above, states do not regulate surplus lines policy forms, which means that a surplus lines policy can contain exclusions that a regulator would never approve in a policy filed by an admitted carrier. A surplus lines policy might contain claim settlement provisions an admitted carrier could not include in its policy form. And surplus lines insurers' rates are not subject to any regulatory oversight. Consumers will not be aware of these differences and limitations – particularly since the legislation removes the consumer disclosures currently required – until a flood event occurs and the consumers face unexpected claims denials or hurdles or, far worse, the surplus lines insurer is financially impaired, unable to pay claims and three is no guaranty fund protection for the policyholder.

Market forces will not cause surplus lines insurers to charge cost-based rates; rather, the surplus lines insurers will charge rates that just beat those of the NFIP even if the cost-based surplus lines rates should be much less. Insurance markets are generally not competitive – consumers rarely have the information and market power to discipline insurers on coverage or prices and rely on state insurance regulators to ensure policy forms (which spell out coverage and claim settlement procedures) are not unfair, deceptive or misleading and to ensure rating practices are fair and not unfairly discriminatory. Flood insurance markets, in particular, are not competitive, so unleashing unregulated insurers on vulnerable consumers is a recipe for disaster.

Thank you for the opportunity to testify today.

Statement of Steven Bradshaw
Executive Vice President
Standard Mortgage

On behalf of the Mortgage Bankers Association

How to Create a More Robust and Private Flood Insurance Marketplace

House Committee on Financial Services
Subcommittee on Housing and Insurance

January 13, 2016

Good Morning, Chairman Leutkemeyer, Ranking Member Cleaver, and members of the subcommittee. I am Steven Bradshaw, Executive Vice President of Standard Mortgage, and I am appearing today on behalf of the Mortgage Bankers Association[1]. Thank you for inviting me to testify about the topic of how to create a more robust and private flood insurance marketplace.

Standard Mortgage Corporation was founded in 1925 in New Orleans and currently services approximately 28,000 loans primarily in the Southeast including Louisiana, Mississippi, Missouri, Florida, Arkansas, and Alabama. We are the largest locally-owned residential mortgage originator and servicer in Louisiana.

This past August marked the 10th anniversary of Hurricane Katrina – the most significant flood event in U.S. history. Standard Mortgage experienced the massive devastation first-hand. Over 3,500 of our servicing customers sustained significant or catastrophic flood damage to their homes. Another 10,000 received various levels of wind damage and minor flooding. On a more person note, two-thirds of our staff lost their homes. In the face of this adversity, many of our staff rallied in our Baton Rouge office building to work with our customers whose lives had been upended by the storm. Two months later, a category 3 hurricane – Rita – struck. Between August 29 and October 24, 2005, Hurricanes Katrina, Rita, and Wilma caused massive devastation and flooding in the Gulf Coast region, damaging more than one million housing units across five states.

Our professional and personal experiences have made clear that there is no doubt the National Flood Insurance Program (NFIP) has served – and will continue to serve in the foreseeable future – a critical need in helping homeowners protect what for many is their most valuable asset. The NFIP was an integral component of the Gulf Coast's recovery just as it has been for communities across the country that have struggled to rebuild after major flooding events.

But there is also no doubt the NFIP – now $23 billion in debt – must be reformed. The program as currently structured is simply not sustainable. The federal government cannot and should not bear the full burden of post-disaster recovery and rebuilding. As Congress recognized when it passed the Biggert-Waters Flood Insurance Reform Act of

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

2012 (BW-12), in order to ensure a stable, affordable, and sustainable flood insurance market, a private market for flood insurance must be allowed and encouraged to develop. Increasing private sector involvement also could benefit consumers and other property owners by expanding available insurance options, lowering costs, and increasing the number of at-risk properties that are insured.

For instance, many homes that were destroyed by Hurricane Katrina were not located in Special Flood Hazard Zones and therefore were not required to have flood insurance. Sadly, these borrowers were often uninsured and the cost of rebuilding fell either on the borrower or, for loans insured by the Federal Housing Administration (FHA), the mortgage servicer if the borrower was unable to repair the home and walked away. A private flood insurance market could offer assistance or varied options to these borrowers.

It is also worth noting that 25 percent of Standard Mortgage's borrowers get their loans through the FHA. FHA borrowers are often first-time home buyers or borrowers with lower incomes or fewer resources to make a down payment. These borrowers are least likely to be able to afford expensive flood insurance premiums or have resources to fall back on in the event of a flood emergency. Currently FHA requires lenders to secure flood insurance on property only if they are located within a high-risk zone. FHA also requires that a servicer must put a property in "conveyable condition" in order to receive insurance benefit, and this includes repairing flood damage. This means we insure FHA against losses when a property floods that is not in a Special Flood Hazard Zones and does not have flood coverage.

The intersection of these requirements can make it difficult or more risky for a lender to do FHA loans in states with significant flood risk or where flood maps may not accurately reflect the current flood risks. These low- and middle-income Americans are thus among those that would benefit most from an expanded marketplace of flood insurances offerings. It can also be expected that expanding coverage options and lowering rates will improve take-up rates for voluntary coverage among other populations.

Increased private sector involvement will also serve to shift some of the burden of post-disaster recovery and rebuilding from taxpayers to the private sector, thereby limiting the federal government's exposure to flood loss.

Though I am aware there are a number of individual House proposals that have been introduced this Congress that would make specific programmatic reforms to the NFIP, I will focus my comments this morning on MBA's support for H.R. 2901, the Flood Insurance Market Parity and Modernization Act. As introduced, the bill would:

I. Clarify what constitutes private flood insurance

Congress can continue to facilitate the development of a private market by resolving legislative and regulatory issues that impede the congressional consensus to encourage the development of a private market. By making it easier for lenders to accept private policies in satisfaction of the mandatory purchase requirement, BW-12 was a significant step in the right direction. However, while the intent was for private flood insurance policies to satisfy the mandatory purchase requirement, the statutory language actually made it more difficult for lenders to accept private policies by requiring private policy coverage to be "at least as broad" as NFIP coverage.

Prior to the enactment of BW-12, lenders for both residential units, as well as commercial and multifamily properties, were permitted to accept private flood insurance to meet the mandatory purchase requirement of the National Flood Insurance Reform Act of 1994. The Federal Emergency Management Agency (FEMA) published guidance with criteria to assist lenders in deciding whether to accept a private flood insurance policy, though lenders retained the discretion to accept a policy that did not meet the FEMA criteria if they were satisfied that the policy adequately covered the collateral. BW-12 incorporated the FEMA criteria into the definition of private flood insurance and required that private policies be "at least as broad as" an NFIP policy in order for a lender to accept it.

While lenders routinely set requirements for various insurance coverages, they do not have the expertise to determine whether a particular private policy selected by a borrower would provide coverage "at least as broad" as NFIP coverage. In addition, the lender typically only receives the declaration page or certificate of insurance at closing – neither of which would provide the level of detail necessary to determine whether coverage is "at least as broad as" coverage provided under the NFIP. With the risk of civil money penalties of $2,000 per violation, lenders are understandably hesitant to accept private flood policies. H.R. 2901 will clarify the statutory language to provide a clear definition of private flood insurance, which will make it easier for lenders to accept private policies.

II. Clarify continuity of coverage requirements

Second, we must make it easier for consumers and property owners to purchase the best policy for their particular needs for the best price. Under current law, it is not clear whether someone who was previously covered under an NFIP policy but moves to a private carrier would be able to later move back to an NFIP policy at their previous rate. This creates a disincentive for consumers to choose a private policy. H.R. 2901 will address this by clarifying that continuous coverage by private flood insurance meets the continuous coverage requirement under the NFIP rules. This clarification will both encourage the development of private market and allow borrowers that choose private coverage the option to return to the NFIP if they wish.

In conclusion, nationwide availability of affordable flood insurance is important to expanding homeownership, protecting borrower equity, limiting investor exposure, and building communities. MBA supports efforts by Congress and the Obama Administration to ensure both the continued strength of the NFIP as well as the development of a private market for flood insurance.

H.R. 2901 effectuates congressional intent to encourage the growth of a competitive and sustainable private flood insurance market. Over time, increased private sector involvement will expand available insurance options and lower costs to consumers, as well as reduce the federal government's exposure to flood loss.

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Testimony of Brady Kelley
Executive Director, National Association of Professional Surplus Lines Offices

Before the
Subcommittee on Housing and Insurance
Committee on Financial Services
United States House of Representatives
"How to Create a More Robust and Private Flood Insurance Marketplace"

January 13, 2016

I. Introduction

Good morning, Chairman Luetkemeyer, Ranking Member Cleaver, members of the Subcommittee. My name is Brady Kelley and I am the Executive Director of the National Association of Professional Surplus Lines Offices (NAPSLO). Thank you for inviting me here today to testify on H.R. 2901, the *Flood Insurance Market Parity and Modernization Act*, an issue that is critically important to our Association.

II. About NAPSLO

NAPSLO is the professional trade association representing the surplus lines industry and the wholesale insurance distribution system. Comprised of approximately 400 wholesale broker member firms, 100 surplus lines insurance companies, and 200 associates and services providers to the surplus lines market, our membership operates in over 1,500 offices representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide – all of whom are committed to the wholesale value distribution system and U.S. surplus lines market. NAPSLO wholesale broker members are placing an estimated $32.7 billion in surplus premium and NAPSLO insurance company members are underwriting an estimated $29.7 billion in surplus lines premium, representing 87% and 79%, respectively, of the U.S. surplus lines market.

Since its incorporation in 1975, NAPSLO has become the authoritative voice of the surplus lines industry, advocating for the industry's vital role in the insurance marketplace and in providing innovative solutions for complex insurance risks.

III. About the Surplus Lines Market

The surplus lines market, also known as the nonadmitted market or E&S market, plays an important role in providing insurance for nonstandard and complex risks. Often called the "safety valve" of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by providing capacity to catastrophe-prone risks and coverage for risks that are declined by the standard underwriting and rating processes of standard/admitted insurance carriers.

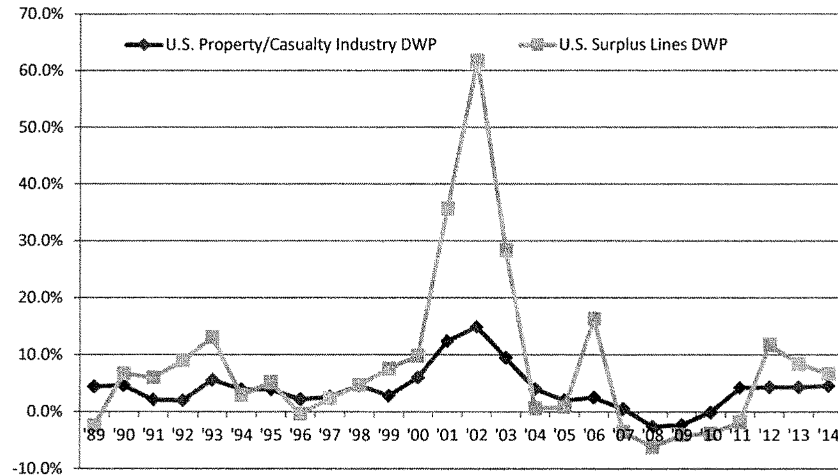
Surplus lines insurance is used to cover risks that are difficult to place because they exceed what the standard market is either capable of or willing to underwrite. A few examples include coastal properties exposed to catastrophic storms, emerging technologies, small business start-ups, and risks with poor credit or located in high crime areas, among a large range of risks where the standard market is unable to provide the level of coverage a consumer needs. Both surplus lines insurers and brokers are specialists who create innovative solutions and deliver customized and cost-effective solutions to meet the insurance consumer's specific needs. It is important to note that, in most cases, the surplus lines market can only be accessed in the event that the standard market is unable or unwilling to place the risk.

With the ability to accommodate a wide variety of risks, the surplus lines market acts as an effective supplement to the standard market, giving consumers insurance options for nonstandard and/or complex risks, as highlighted in catastrophe-prone areas of the country. States such as California, Florida, Louisiana, New Jersey, New York, Pennsylvania and Texas are good examples of how the surplus lines industry has acted as an effective market in responding to catastrophic events, where consumers may otherwise have been left without coverage for their commercial risks and/or personal assets.

All states with a history of dealing with catastrophic storms have been impacted by the normal, downward shift in the standard market's appetite for providing coverage in the wake of catastrophic losses. The surplus lines industry has been able to serve as an effective supplement in such cases, offering consumers options that may no longer exist in the standard market. Such events result in an ebb and flow of business and risk appetite between the standard and surplus lines markets – a market cycle that has demonstrated to be quite effective for decades and illustrates the supply and demand for insurance products.

Exhibit I illustrates this market cycle by measuring the rates at which U.S. surplus lines direct written premium has shifted upward or downward in relation to the U.S. property casualty industry direct written premium. Catastrophic events such as Hurricane Andrew in August 1992, the Northridge Earthquake in January 1994, the September 11, 2001 terrorist attacks, Hurricanes Katrina in August 2005, Rita in September 2005, Wilma in October 2005, Ike in September 2008, Irene in August 2011 and Superstorm Sandy in October 2012 are followed by growth in surplus lines premium, which exceeds the rate of growth in the overall property/casualty market. The reverse is true in other years with lower catastrophic activity.

Exhibit I



A. Types of Risks Typically Written in the Surplus Lines Market

While the surplus lines market is not the primary market for most insurance coverages, it is a critical market as supply and demand for insurance ebbs and flows. As an example, the first admitted homeowner's policy was filed and approved in 1950, having fire, theft and liability coverages combined into a single policy. Today, consumers expect to see these combined coverages in all standard policies. The surplus lines market allows this type of innovation to occur much more quickly and efficiently.

The surplus lines industry generally serves as the innovator for new and emerging risks and related insurance products, such as vacant properties, nursing homes, builder's risk and older high-value homes. For example, a new business venture with a new innovative product may not be able to find insurance in the standard market, because of the lack of experience, loss history and approved underwriting processes or rates for emerging risks. Other examples of coverage innovations in surplus lines that now have evolved to the standard market include employment practices liability, directors and officer's liability, medical malpractice and cyber risk, among many others.

A strength of the surplus lines industry is its ability and flexibility to customize coverage for new and emerging risks. Surplus lines insurers do this by focusing on underwriting for the specific risk to be insured. In order to ensure new or unique risks are underwritten appropriately, surplus lines insurers are highly specialized and conduct specific research to understand the underlying exposure. As loss histories develop on these product lines, the standard market will leverage the data and experience from the surplus lines market to develop more standardized products, rates and forms that offer similar solutions.

Conversely, when the standard market experiences significant or catastrophic losses in certain product lines or regions (e.g., catastrophic storms in coastal states), their underwriting practices and risk appetites become more conservative resulting in a shift of these risks back to the surplus lines market. The states have a successful record of dealing with catastrophic storms that have impacted the willingness of standard insurers to provide coverage and limits in the availability of private insurance for their constituents. The surplus lines industry has been able to serve as an effective supplement in such cases, offering consumers options that no longer exist in their standard market. In this regard, the relationship between the standard and surplus lines markets are symbiotic.

IV. The Issue: Need to Ensure Consumers Continue to Have Surplus Lines as an Option in the Private Flood Insurance Market

Surplus lines insurance provides an important option for consumers seeking coverage for unique or hard to place risks, including flood risks. As discussed below, NAPSLO supports HR 2901 as it seeks to preserve that consumer option.

A. NFIP and the Private Flood Insurance Market

In 1968, Congress established the National Flood Insurance Program (NFIP) to make up for a lack of available flood insurance from the private insurance market. While the program has certainly enabled property owners in participating communities to purchase insurance protection from the federal government, the NFIP has now borrowed $23 billion from the U.S. Treasury. With continued subsidies in the NFIP's rates, this debt is only anticipated to grow and the pace at which the private market, especially the standard market, is willing and able to develop competitive flood insurance programs for consumers will continue to be slow. Congress recognized these trends during the 2012 NFIP reauthorization and included provisions to encourage a more active participation by the private market.

B. Current State of Surplus Lines Flood Market

Generally speaking, consumers whose risks do not fit within the terms and limits of the NFIP or whose risks are declined by the standard market will have brokers looking to the surplus lines market for solutions. Consumers will and do need alternatives to the NFIP[1] when: (1) they need higher limits than the $250,000 residential, $100,000 personal contents and $500,000 commercial limits offered by the NFIP; (2) they need enhanced coverage from that offered by the NFIP such as replacement cost of the damaged property rather than the actual cash value of the property, additional sublimits, additional structures, or the ability to schedule multiple properties on one policy; or (3) they need additional coverage beyond that offered by the NFIP such as additional living expense, basements, or business interruption for commercial entities.

For 2014, six of the 14 states with surplus lines stamping offices have collected specific flood policy data (California, Florida, Mississippi, Nevada, New York and Texas), including four of our

[1] Attachment A

largest surplus lines states (California, Florida, New York and Texas). These six states reported $134.1 million in flood premium in 2014 compared to the $19.8 billion in total surplus lines premium written in these states – only .68% of their total surplus lines premium is for flood risks. These states are fairly representative of the entire U.S. market because they comprise more than 49% of the $40.2 billion surplus lines market in 2014. So, if we extrapolate this proportion to the U.S. market, we would estimate roughly $273.6 million in surplus lines flood insurance premium nationwide.

Of the $134.1 million in flood premium:

- $92.0 million or 69% covers commercial property
- $32.9 million or 24% covers residential property
- $9.2 million or 7% is not specifically characterized as either commercial or residential property

Further, when analyzing surplus lines premium in these six states from 2011 through 2014, we find premium ranged from $119.2 million in 2011 to the $134.1 million in 2014, with ups and downs within that period, but no dramatic or systemic trends other than the ebb and flow of business that we have been referencing here today. In fact, surplus lines flood insurance premium in these six states totaled $450.4 million from 2011 to 2014, or .64% of their total surplus lines premium (i.e., consistent with the .68% in 2014).

<u>Although flood insurance represents a relatively small proportion of the surplus lines market, it represents a market for consumers that would otherwise have no solution.</u>

NAPSLO believes the private market will develop, but slowly. For consumers whose flood risks are mitigated by the terms and limits available from the NFIP, there will be no real change or shift of NFIP coverages to the private market. As long as the NFIP continues to subsidize rates and delay the implementation of more actuarially sound rates commensurate with underlying exposures, there is no incentive for consumers to seek private market solutions and no incentive for the private market to develop solutions that cannot compete.

For consumers who seek private market alternatives to the NFIP, the standard/admitted market will serve as the primary solution for risks that fit within the standard pricing and underwriting criteria of standard/admitted insurance carriers. Again, we believe it will take time for the standard market to develop the experience and data to support standard pricing and underwriting criteria. We believe the standard market's understanding of and comfort with flood exposures will develop from the surplus lines market's experience. Currently, our understanding is that most standard market offerings are additions to existing property policies rather than new standalone flood insurance programs. This is primarily because the rates needed to compete with the NFIP do not support standalone programs.

Consumers whose risks do not fit within the terms and limits of the NFIP or whose risks are declined by the standard market will have brokers looking to the surplus lines market for solutions. <u>Without it, consumers who need it will have no alternative.</u>

As a result, NAPSLO does not anticipate any significant change or expansion in the surplus lines market, except to the extent the demand for flood insurance exceeds that available from the NFIP or standard market (e.g., in the event NFIP or standard market options deteriorate).

C. Support of the Flood Insurance Market Parity and Modernization Act

NAPSLO strongly supports H.R. 2901, the *Flood Insurance Market Parity and Modernization Act*, as introduced by Representatives Ross and Murphy, because it amends the definition of private flood insurance to clarify that surplus lines insurers are eligible to offer private market solutions and alternatives to consumers with unique and complex flood risks.

Although surplus lines insurance companies are currently allowed to provide private flood insurance, the definition of private flood insurance implemented during the 2012 revisions to provisions in 42 U.S.C.A. §4012a created uncertainty for lenders and consumers. Specifically, lenders became uncertain about accepting surplus lines insurance policies in light of the law's requirements and because it authorized federal banking and housing regulators and the government-sponsored enterprises (GSEs) to develop their own requirements related to the financial strength and claims-paying ability of private insurance companies writing private flood insurance. No regulations have been developed by the banking and housing regulators or GSEs, which is prolonging this uncertainty. As a result, lenders have rejected perfectly valid, well-underwritten insurance policies because they were afraid to accept the policy under current law.

This is a problem. For example, a borrower needs a flood policy to cover residential rental property, including lost rental income. The current NFIP policy does not provide enough coverage per property. The NFIP also requires individual policies to be written and does not provide lost rental income coverage. While this coverage can be made available in the surplus lines market, lenders have been reluctant to accept such a policy in light of the existing definition of private flood insurance in federal law. The lender, borrower and broker are each forced to make a choice – take one surplus line policy and fully protect the property, or take several NFIP policies that do not fully satisfy the borrower's coverage needs.

H.R. 2901 will amend the definition of private flood insurance to provide lenders with the certainty they need to accept surplus lines flood insurance policies and will ensure consumers have access to the options they need from the surplus lines market. It is important to remember that surplus lines flood insurance policies were written for insureds unable to secure flood insurance from the NFIP or standard market prior to the 2012 revisions. H.R. 2901 simply preserves the surplus lines market's ability to solve unique and complex flood insurance risks that exceed or differ from the options available through the NFIP or the standard market. NAPSLO's support for this legislation stems from our desire to preserve that choice for consumers.

In addition, NAPSLO strongly believes that the authority to regulate insurance companies and insurance markets should remain under the purview of state insurance regulators because of their experience and strong track record of successful regulation in the U.S. We share the NAIC's concern that banking and housing regulators do not have the experience or expertise to regulate insurance companies or insurance markets. We would also be concerned with the duplicative

and likely inconsistent regulatory requirements for insurers that we too are concerned would result.

V. Background on Surplus Lines Insurance

A. State Regulation of the Surplus Lines Market

There are key similarities in state regulation of the surplus lines and standard markets. First, each U.S. based surplus lines insurance company is licensed in at least one of the 50 states or other U.S. jurisdictions and must maintain threshold capital and surplus levels. Surplus lines insurers domiciled outside of the U.S. may be included on the NAIC Quarterly Listing of Alien Insurers upon meeting capital and surplus requirements, agreeing to maintain U.S. trust accounts, and meeting certain character, trustworthiness and integrity requirements, a process overseen by state insurance regulators through the NAIC's International Insurers Department. Second, to obtain and maintain their licenses, both standard and surplus lines insurers are subject to all of the same rigorous rules and regulations and must comply with all financial solvency requirements and market conduct standards and regulations of its state or jurisdiction of domicile.

There are also a couple of key differences. First, surplus lines insurers generally do not write surplus lines in their state of domicile; rather the surplus lines insurer's business is generally written in other states where the insurer operates on a surplus lines basis. Second, in a surplus lines transaction, both the surplus lines insurer and the broker are regulated. In accordance with the *Nonadmitted and Reinsurance Reform Act of 2010*, the insured's home state requires a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to such insured. Perhaps most importantly, in the typical surplus lines transaction, the surplus lines broker (often a wholesale broker with a high level of expertise in the underlying risk) works directly with the retail agent or and broker representing the insurance consumer who needs the nonstandard insurance solution. In this regard, and also distinct from the standard market, the licensed surplus lines broker is responsible for (1) placing the coverage with a financially strong, eligible surplus lines insurer; (2) reporting the surplus lines transaction to insurance regulators; (3) remitting the premium tax due on the transaction to state tax authorities; and (4) assuring compliance with all the requirements of the surplus lines regulations for that state.

B. State Regulatory Controls

As a supplemental market, generally speaking, the surplus lines market does not compete with the standard market; rather, the surplus lines market provides coverage options (e.g., supplemental coverages, higher limits, unique terms and conditions, etc.) when the standard market cannot or will not underwrite the level of flood coverage needed. State insurance regulators leverage two important tools to monitor and control the types of coverages that can be placed in the surplus lines market – diligent search requirements and export lists.

First, most state statutes and/or regulations require insurance agents to demonstrate a diligent effort was made to place the risk with the standard market. These requirements are often referred to as diligent search requirements within state laws and regulations. In practice,

insurance agents will generally seek insurance quotes for flood risks from the NFIP and standard market carriers licensed to write such insurance. If the risk is declined by the NFIP or standard market (most states require declinations from three markets that write the type of coverage being solicited), insurance agents may seek coverage from the surplus lines market. Consequently, a residential property owner will not access flood insurance solutions directly from the surplus lines market.

Second, regulators use "export lists" to regulate the flow of business between the standard and surplus lines markets. An export list outlines the types of insurance products and coverages the state allows to be exported to the surplus lines market without a diligent search of the standard market. They represent an effective tool for each individual state to monitor and regulate their own insurance markets. The fact that the export lists vary by state, (i.e., there is no national, multi-state export list) is evidence that not all products and coverages are available in all states on a standard basis and that insurance regulators have recognized the need for this option for their consumers.

A number of states have either added primary flood insurance to their export list or are waiving diligent search requirements for flood coverage because of the need to develop private market solutions in their states. Excess flood insurance (e.g., flood coverage in excess of the primary limits of the NFIP) is even more prevalent across the country. In these cases, the surplus lines market can offer competitive options for consumers. Specifically, 18 states allow direct access to the surplus lines market for various levels of flood insurance. 11 states (Alaska, Arizona, Connecticut, Florida, Idaho, Louisiana, New Jersey, Oklahoma, Pennsylvania, Virginia and Wisconsin) have no restrictions on accessing the surplus lines market for flood insurance. California and West Virginia specifically allow access to the surplus lines market for excess coverage. Four states (Maryland, Michigan, New Mexico and New York) have made immediate access to the surplus lines market available where the insured's community does not participate in the NFIP, or when the coverage needed is in excess of the NFIP. Finally, Nevada allows direct access for flood coverage in the case of lender-placed insurance. Florida and Oklahoma have passed specific laws to allow direct access to primary and excess flood coverage from the surplus lines market.

While H.R. 2901 is not intended to expand the surplus lines market share in private flood insurance, we recognize that those states adding flood to their export lists or waiving diligent search requirements are doing so to build private market solutions for their consumers. We strongly support the states in their monitoring and use of these tools to regulate the supply and demand of flood insurance coverage for their constituents.

Given the strong state based insurance regulatory system, we can rely on state insurance regulators to use these tools to respond to the needs and protection of their consumers. H.R. 2901 will preserve state insurance regulatory oversight and control over the types of coverages that can be placed in the surplus lines market.

C. Proven Financial Strength and Stability

In 2014, the surplus lines market represented $40.2 billion in direct written premium, approximately 7% of the entire property and casualty market and near 14% of commercial lines premium. Surplus lines insurers have an exemplary solvency record when compared to the standard property/casualty industry. The most recent five and ten-year track record of the surplus lines industry exemplifies this disparity, as outlined in the annual A.M. Best report[2]. This report is issued annually and reviews the financial strength of the surplus lines market from the research and perspective of the rating agency. The most recent report highlights that for the eleventh year in a row, the surplus lines industry reported no financially impaired companies in 2014. In contrast, the admitted property/casualty industry experienced 207 disclosed financial impairments over the same eleven-year period.

As outlined in Exhibit II, the surplus lines marketplace is financially secure and dominated by companies with average ratings that exceed those of the overall property/casualty industry as follows.

Exhibit II

Best's Rating Distribution
As of August 2015

Best's Financial Strength Rating		Domestic Professional Surplus Lines		Total P/C Industry	
Level	Category	# of Companies	Percentage	# of Companies	Percentage
A++	Superior	8	8.79%	24	2.75%
A+	Superior	21	23.08%	81	9.28%
A	Excellent	43	47.25%	290	33.22%
A-	Excellent	18	19.78%	285	32.65%
B++	Good	1	1.10%	94	10.77%
B+	Good	-	0.00%	59	6.76%
Subtotal		91	100.00%	833	95.42%
B	Fair	-	0.00%	25	2.86%
B-	Fair	-	0.00%	7	0.80%
C++	Marginal	-	0.00%	1	0.11%
C+	Marginal	-	0.00%	3	0.34%
C	Weak	-	0.00%	3	0.34%
C-	Weak	-	0.00%	1	0.11%
D	Poor	-	0.00%	-	0.00%
E	Under Regulatory Supervision	-	0.00%	-	0.00%
F	In Liquidation	-	0.00%	-	0.00%
Subtotal		-	0.00%	40	4.58%
Totals		91	100.00%	873	100.00%
Not Rated		4		970	
		95		1,843	

[2] Attachment B

VI. **Conclusion and Reiteration of Support**

Although surplus lines insurance companies are currently allowed to provide private flood insurance, the definition of private flood insurance should be revised to remove any uncertainty for lenders or consumers that, pursuant to state rules and regulations, surplus lines insurance companies continue to be eligible to offer private market solutions and alternatives to consumers in need of unique and complex flood risks. The *Flood Insurance Market Parity and Modernization Act* solves this problem.

This legislation is intended to provide much needed private market alternative solutions to consumers' flood insurance needs, both commercial and residential. NAPSLO's primary goal in supporting H.R. 2901 is to preserve the surplus lines market's ability to offer alternatives for flood risks that exceed or differ from the options available through the NFIP or the standard market. Without it, consumer options will be restricted. NAPSLO encourages your support of this legislation and we urge Congress to take quick action to enact it.

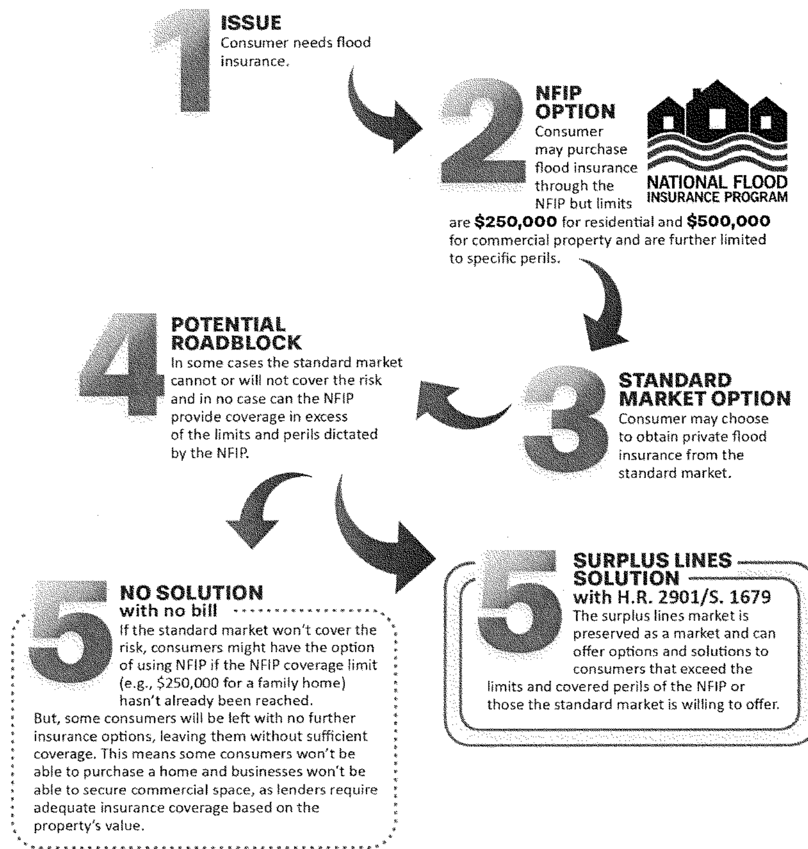
We appreciate Congressmen Ross and Murphy for their leadership in introducing H.R. 2901 and we thank them and the Subcommittee for its effort to encourage greater growth in the private flood insurance market. We encourage your support of the legislation as introduced, and we urge Congress to take quick action to enact it.

Thank you again for the opportunity to be here today, and we look forward to working with you as H.R. 2901 moves forward.

Attachment A

Consumer Options for Flood Insurance

The current definition of private flood insurance causes uncertainty regarding the role that surplus lines insurance can continue to play in fulfilling a consumer's obligation to purchase flood insurance. H.R. 2901/S. 1679 was introduced in June 2015 to ensure consumers continue to have surplus lines options when securing flood insurance from the private market.



U.S. Surplus Lines
Record Levels Reached

Attachment B

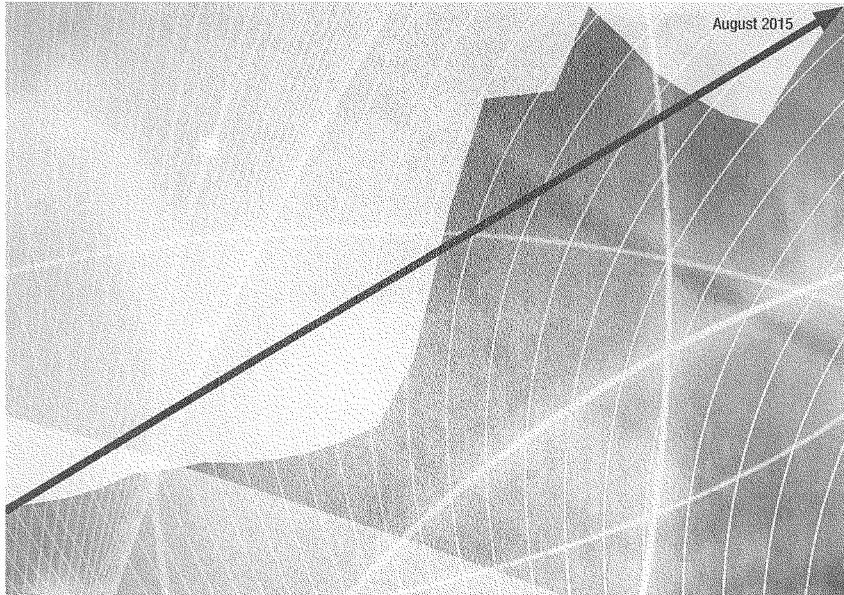


Exhibit D

Segment Review
August 27, 2015

Surplus Lines Profit from Underwriting Discipline and Core Competencies

Product diversification, underwriting discipline and market conditions drive profitable 2014 surplus lines results.

Underwriters of surplus lines continued to report profitable results in 2014 including profits from favorable reserve development. Results were driven by a combination of product diversification, underwriting discipline, and advantageous market conditions. As a result, surplus lines companies continue to outperform the overall property/casualty industry and recorded a second straight year of underwriting profitability following three years of underwriting losses.

A. M. Best's outlook on the surplus lines insurance market remains stable. In addition, the overall macroeconomic environment has been conducive to increased merger and acquisition (M&A) activity. We have seen over the past five years that surplus lines, as well as specialty admitted carriers, have been the target of M&A. Targeted companies provide acquirers an opportunity either to establish a new surplus lines platform, or to supplement an existing one.

Surplus lines insurers also have kept pace with Enterprise Risk Management tools and processes due to increased oversight by regulators and rating agencies. Management at these firms have taken a closer look at their operations from an enterprise standpoint and have either better formalized existing programs or made the necessary adjustments to be more in-line with peers.

The persistent low interest rate environment continues and investment portfolio returns suffer as carriers struggle to replace maturing, and higher yielding, securities with suitable replacements without adding to credit and liquidity risk.

In January 2015, NARAB II was signed into law by President Obama as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. The market view is that NARAB II will make it easier for agents and brokers to conduct business and make the licensing process more streamlined. Productivity is expected to improve and the cost of business and compliance to decrease.

One of the hallmarks of the surplus lines insurance market is the development of new insurance solutions to address new or emerging risks, or to provide improved coverage for known risks. The core competencies of the successful surplus lines carriers remain the same, focused on effective strategic analysis, product diversification and underwriting discipline. These companies typically concentrate more on bottom-line profits than top-line organic growth, utilizing the segment's freedom of rate and form, while providing coverage for the varied, nonstandard risks that they underwrite. This focus gives these insurers the best chance to withstand adverse market circumstances and succeed over the long term.

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SR-2015-117

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A.M. Best Surplus Lines Market Report - A Retrospective

More than two decades ago, A.M. Best published *Best's Insolvency Study: Property/Casualty Insurers 1969-1990*, in an effort to inform then-active debates over insurers' solvency. Sparked by interest in this topic, the Derek Hughes/NAPSLO Educational Foundation commissioned a similar study in 1994, on the solvency record of the domestic surplus lines industry. The segment was poorly understood by many at the time, but the data showed that, conventional wisdom aside, the surplus lines market's financial stability and solvency were at least on par with the overall property/casualty (P/C) industry.

Over the ensuing years, A.M. Best has published annually a special report on the surplus lines market, commissioned by the Foundation that has documented:

- The market's role in covering new or emerging risks, distressed risks, high-capacity risks, and unique risks that cannot be insured in the standard P/C market.
- The importance of surplus lines insurers' freedom of rate and form, which has allowed for creative insurance solutions to meet specific or unique coverage needs.
- The role of surplus lines distributors, including wholesalers and managing general agents (MGAs), which have played a critical and still growing part in developing products and forging relationships with insureds that facilitate the placement of business in this market.

Throughout its history, the surplus lines market has faced significant obstacles and intense competition. This includes aggressive pricing and liberal coverage from standard market carriers seeking organic growth, and the alternative risk transfer market's appeal as another means of covering potential surplus lines risk. Meanwhile, surplus lines industry representatives have been active in Washington D.C. and individual states on critical regulatory issues affecting the industry, advancing key pieces of legislation. Among these were the National Association of Registered Agents and Brokers (NARAB) provision of the 1999 Gramm-Leach-Bliley Act, which led to nonresident surplus lines agent and broker licenses and a new landscape in wholesale and MGA distribution. More recent actions include passage of the Nonadmitted and Reinsurance Reform Act in 2010, passage of NARAB II, along with the Terrorism Risk Insurance Program Reauthorization Act of 2015 and the introduction of new federal Flood legislation (see section III of this report).

Despite the challenges, the surplus lines market more than doubled from 3.3% of total P/C direct premiums written (DPW) in 1994 to approximately 7.1% by the end of 2014. As a percentage of commercial lines DPW, surplus lines insurers grew from a 6.1% share to 13.9%, hence further demonstrating the undeniable importance of the sector within the overall P/C industry.

Surplus lines companies in 1994 held a higher median A.M. Best financial strength rating (FSR) than the total P/C industry; 85.4% of surplus lines companies had secure ratings (defined as an A.M. Best rating from B+ to A++), compared to 74.2% for the industry. Through mid-year 2015, 100% of surplus lines companies maintained secure ratings versus 95.4% for the P/C industry. Most noteworthy is that 99% of surplus lines insurers have A.M. Best ratings of A- or higher, compared with 78% for the total P/C industry – further corroborating the health of the surplus lines sector today.

The surplus lines market clearly is a safety valve for the insurance industry, especially in hard markets. As emerging issues and exposures drive more demand for creative, comprehensive insurance solutions, A.M. Best believes the surplus lines market will continue to gain in prominence.

Section I – State of the Market

Continuing the momentum established in 2012 and 2013, the surplus lines sector ended the 2014 year in strong form. Leading the parade for this sector was nearly $1 billion of net underwriting profit which included over $525 million of net accident year underwriting profit, plus $376 million of additional profits taken from prior years in the form of favorable reserve development.

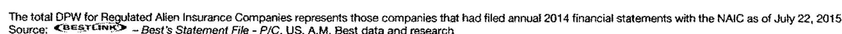
During the year, price momentum continued as direct premiums in this sector grew 6.7% (see **Exhibit 1**) despite competitive pressures domestically and abroad, robust balance sheets in need of putting capital to work, as well as new entrants. There is no doubt that insurers and underwriters have resigned themselves to the reality of today's low interest rate environment and the fact that we are likely to remain in this malaise for some time.

Exhibit 1

U.S. Surplus Lines – Direct Premiums Written (DPW) by Segment (1988-2014)

(USD millions)

	Total P/C Industry		Total Surplus Lines		DOMESTIC PROFESSIONALS				LLOYD'S			REGULATED ALIENS (excluding Lloyd's)				DOMESTIC SPECIALTY			
Year	DPW	Annual % Chg	DPW	Annual % Chg	DPW	Annual % Chg	Surplus Lines Market Share	No. of Cos.	DPW	Annual % Chg	Surplus Lines Market Share	DPW	Annual % Chg	Surplus Lines Market Share	No. of Cos.	DPW	Annual % Chg	Surplus Lines Market Share	No. of Cos.
1988	211,270	4.2%	6,281	-4.3%	3,704	-10.4%	59.0%	86	1,237	-7.5%	19.7%	1,012	31.3%	16.1%	104	328	2.2%	5.2%	128
1989	220,620	4.4%	6,123	-2.5%	3,530	-4.7%	57.7%	88	1,182	-4.4%	19.3%	1,050	3.8%	17.1%	101	361	10.1%	5.9%	123
1990	230,757	4.6%	6,532	6.7%	3,882	10.0%	59.4%	117	1,241	5.0%	19.0%	1,013	-3.5%	15.5%	85	396	9.7%	6.1%	149
1991	235,627	2.1%	6,924	6.0%	4,081	5.1%	58.9%	117	1,322	6.5%	19.1%	1,111	9.7%	16.0%	85	410	3.5%	5.9%	151
1992	240,410	2.0%	7,549	9.0%	4,491	10.0%	59.5%	120	1,388	5.0%	18.4%	1,220	9.8%	16.2%	74	450	9.8%	6.0%	151
1993	253,847	5.6%	8,540	13.1%	5,270	17.3%	61.7%	123	1,631	17.5%	19.1%	1,183	-3.0%	13.9%	70	456	1.3%	5.3%	138
1994	263,653	3.9%	8,786	2.9%	6,089	15.5%	69.3%	115	1,196	-26.7%	13.6%	992	-16.1%	11.3%	64	509	11.6%	5.8%	141
1995	273,929	3.9%	9,245	5.2%	6,511	6.9%	70.4%	112	1,300	8.7%	14.1%	1,022	3.0%	11.1%	57	412	-19.1%	4.5%	144
1996	279,990	2.2%	9,205	-0.4%	6,668	2.4%	72.4%	108	1,354	4.2%	14.7%	818	-20.0%	8.9%	57	365	-11.4%	4.0%	125
1997	287,196	2.6%	9,419	2.3%	6,569	-1.5%	69.7%	106	1,609	18.8%	17.1%	802	-2.0%	8.5%	59	439	20.2%	4.7%	114
1998	300,309	4.6%	9,861	4.7%	6,763	3.0%	68.6%	107	1,574	-2.2%	16.0%	1,196	49.1%	12.1%	58	328	-25.3%	3.3%	113
1999	308,671	2.8%	10,615	7.6%	7,265	7.4%	68.4%	105	1,912	21.5%	18.0%	1,140	-4.7%	10.7%	55	298	-9.1%	2.8%	116
2000	327,286	6.0%	11,656	9.8%	7,884	8.5%	67.6%	98	2,499	30.7%	21.4%	941	-17.5%	8.1%	46	332	11.4%	2.8%	106
2001	367,798	12.4%	15,813	35.7%	10,773	36.6%	68.1%	104	3,368	34.8%	21.3%	1,362	44.7%	8.6%	44	310	-6.6%	2.0%	91
2002	422,703	14.9%	25,565	61.7%	19,572	81.7%	76.6%	108	4,082	21.2%	16.0%	1,600	17.5%	6.3%	46	311	0.3%	1.2%	76
2003	463,033	9.5%	32,799	28.3%	25,662	31.1%	78.2%	115	4,492	10.0%	13.7%	2,400	50.0%	7.3%	45	245	-21.2%	0.7%	63
2004	481,588	4.0%	33,012	0.6%	25,744	0.3%	78.0%	115	4,596	2.3%	13.9%	2,400	0.0%	7.3%	53	272	11.0%	0.8%	59
2005	491,429	2.0%	33,301	0.8%	25,968	0.9%	78.0%	111	4,675	1.7%	14.0%	2,400	0.0%	7.2%	50	238	-12.5%	0.7%	57
2006	503,894	2.5%	38,698	16.3%	29,410	13.3%	76.0%	117	5,989	28.1%	15.5%	3,100	29.2%	8.0%	55	199	-16.4%	0.5%	54
2007	506,180	0.5%	36,637	-3.5%	27,675	-5.9%	74.1%	120	6,360	6.2%	17.0%	3,100	0.0%	8.3%	55	202	1.5%	0.5%	56
2008	492,881	-2.6%	34,365	-6.2%	24,612	-11.1%	71.6%	130	6,062	-4.7%	17.6%	3,403	9.8%	9.9%	53	288	42.6%	0.8%	70
2009	481,410	-2.3%	32,952	-4.1%	22,830	-7.2%	69.3%	139	6,090	0.5%	18.5%	3,735	9.8%	11.3%	55	297	3.1%	0.9%	69
2010	481,120	-0.1%	31,716	-3.8%	21,882	-4.2%	69.0%	143	5,789	-4.9%	18.3%	3,758	0.6%	11.8%	56	287	-3.4%	0.9%	66
2011	501,555	4.2%	31,140	-1.8%	22,582	3.2%	72.5%	146	5,790	0.0%	18.6%	2,537	-32.5%	8.1%	53	231	-19.5%	0.7%	60
2012	523,360	4.3%	34,808	11.8%	25,490	12.9%	73.2%	142	6,270	8.3%	18.0%	2,747	8.3%	7.9%	61	301	30.3%	0.9%	53
2013	545,760	4.3%	37,719	8.4%	26,818	5.2%	71.1%	140	7,099	13.2%	18.8%	3,362	22.4%	8.9%	59	440	46.2%	1.2%	49
2014	570,187	4.5%	40,234	6.7%	28,274	5.4%	70.3%	135	8,157	14.9%	20.3%	3,302	-1.8%	8.2%	60	501	13.9%	1.2%	58



The total DPW for Regulated Alien Insurance Companies represents those companies that had filed annual 2014 financial statements with the NAIC as of July 22, 2015.
Source: BESTLINK – *Best's Statement File - P/C*, US, A.M. Best data and research

In general, the market position of surplus lines insurers continues to be described in favorable terms such as profitable, stable, well-capitalized and consistent performers. These attributes are the result of effective strategic analysis, product diversification, underwriting discipline, advantageous market conditions, and an environment conducive to opportunistic mergers and acquisitions. With a business profile that industry members traditionally refer to as "counter-cyclical", these carriers are extending their trends of favorable overall profitable results. Though some carriers have encountered difficulties, in general the surplus lines carriers remain strong performers and in control of their circumstances.

In our 2015 review of the state of the surplus lines market, A.M. Best will discuss many points, including:

- Market share of the leading members of this line of business
- Factors contributing to financial performance
- Merger and acquisition activity impacting these carriers
- A.M. Best's views on the near-term market cycle.

One advantage to surplus lines insurers is their ability to obtain new business declined by standard carriers at a price deemed supportive of the risk profile. The results for these companies are growth in premium levels, improvement in cash flow, and expansion of the invested asset base. These factors and others led to the surplus lines market recording a second straight year of underwriting profitability following three years of net underwriting losses. It is worth noting that there were no large scale weather events in either 2013 or 2014. A complete review of the aggregate financial results is provided in Section II of this report.

Over the past five years, surplus lines as well as specialty admitted insurers have been the target of mergers and acquisitions (M&A). This is also true of existing insurers who have formed new surplus lines platforms and those that decide to build out their existing platforms. In most cases, M&A activity features strong performing companies targeting other strong performers. This is highlighted by the June 10, 2015 announcement of Tokio Marine & Nichido Fire Insurance Co., Ltd., already active in the U.S. surplus lines market, acquiring HCC Insurance Holdings, Inc. (a key participant in the surplus lines market). HCC, in turn, had recently acquired ProAg Insurance. Additional M&A activity over the past year includes Global Indemnity's purchase of American Reliable and Fosun Group's acquisition of Meadowbrook Insurance. These actions merely mirror similar activity across the insurance industry.

While the latest two years have produced strong profitability, results in earlier years were impacted by weather related losses including Superstorm Sandy in 2012. That event was significant by any measure, and for many surplus lines carriers, it pushed incurred losses to record levels producing results that were outside historical trends and resulted in combined ratios for the Domestic Professional Surplus Lines (DPSL) that exceeded the ratios for the overall property/casualty industry for the first time in more than a decade. In the aftermath, many insurers revisited their books of business in terms of insured exposures and policy terms and conditions.

Enterprise risk management (ERM) programs continue to grow in prominence within organizations, with regulators and rating agencies alike looking to management teams to incorporate or revisit risk appetite and tolerance statements within their ERM structures. In order to adhere to these guidelines, most companies have worked proactively to be compliant while others are trying to keep pace revisiting risk management frameworks, processes and procedures, exposure aggregations, and risk mitigation tactics.

The continuing investment market challenges such as low return rates and headline making defaults (Detroit, Harrisburg, and Puerto Rico) apply negative pressure to portfolios. Carriers with strong balance sheets featuring available capital are under pressure to improve return on equity rates. These conditions are leading standard market carriers to exert greater pricing discipline and minimize risk, while leading surplus lines carriers to exhibit more conservative rate management in concert with obtaining premium levels in-line with loss costs. The end result has been improved performance outcomes across both markets.

The total surplus lines direct written premium is distributed across a variety of corporate structures and company domiciles. **Exhibit 5** consolidates the distribution of premium by segment, representing the increases across the line and by segment. A.M. Best believes this reflects an expanding appetite for appropriately underwritten surplus lines business, including business written through Lloyd's syndicates.

Exhibit 2
Surplus Lines Specialists – Operating Performance (2014)
(%)

Group Name	Change in DPW	Loss/LAE Ratio	Combined Ratio	Pre-Tax ROR (%)	Pre-Tax ROE (%)
Alleghany Insurance Holdings	3.3	54.7	89.1	23.0	14.4
Arch Insurance Group	18.7	64.7	96.1	8.0	6.6
Argo Group	3.8	62.1	97.3	13.3	7.6
AXIS Insurance Group	-0.4	73.4	109.8	-2.2	-1.3
Catlin U.S. Pool	17.6	76.3	97.8	4.1	2.7
Global Indemnity Group	-8.6	62.1	104.1	2.2	1.8
HCC Insurance Group	3.1	47.1	77.5	35.1	14.0
IFG Companies	-11.1	56.4	98.3	11.5	4.6
James River Insurance Company	44.6	56.4	88.7	33.3	10.8
Markel Corporation Group	4.7	57.0	95.8	10.6	8.8
RLI Group	2.2	43.2	84.0	25.3	20.4
W. R. Berkley Group	10.3	59.3	91.7	20.6	19.3
Western World Insurance Group	17.8	23.8	57.8	50.4	35.3
Average - Surplus Lines Specialsts	**8.2**	**56.7**	**91.4**	**18.1**	**11.2**
Total P/C Industry	**4.5**	**69.0**	**97.2**	**12.8**	**9.2**

Source: BESTLINK – A.M. Best Co.'s AMB Credit Report - Insurance Professional

Surplus lines specialists provide wide ranging product diversification to cover the varied exposures that require critical insurance solutions in the market. These specialists, as shown in **Exhibit 2** and **Exhibit 3** generate a significant amount of operating profits, solid returns and favorable reserve development. Surplus lines specialists are U.S. domiciled insurers that primarily write surplus and / or specialty admitted business. These specialists largely exclude companies or groups that are part of a much larger, global multiline insurance operation, but include some specialty groups with Bermuda-based parents.

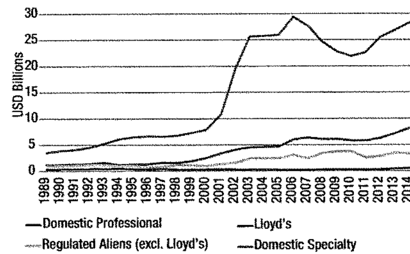
Reserve adequacy is a material component of A.M. Best's assessment of overall capital adequacy and the ongoing trend of favorable though tightening reserve development for the surplus lines market has been recognized. A.M. Best continues to expect this ability to benefit from favorable reserve development to dissipate. The point at which the industry as a whole is unable to sustain consolidated favorable reserve development may be nearer than before. However, surplus lines carriers that are able to maintain conservative loss reserve selections and support strong balance sheet positions will likely

Exhibit 3
Top Surplus Lines Specialists – Loss Reserve Development (2014 Calendar Year)
(USD thousands)

Group Name	One-Year Loss Reserve Development Through 2014 (000)	One-Year Development to Original 2013 Reserves (%)
Alleghany Insurance Holdings	-$218,284	-2.2%
Arch Insurance Group	-$31,754	-2.2%
Argo Group	$2,175	2.0%
AXIS Insurance Group	-$99,596	-5.5%
Catlin U.S. Pool	$13,189	9.9%
Global Indemnity Group	$5,920	2.2%
HCC Insurance Holdings	-$70,546	-4.0%
IFG Companies	-$13,434	-3.5%
James River Insurance Company	-$15,604	-13.3%
Markel Corporation Group	-$164,276	-5.6%
RLI Group	-$66,967	-9.2%
W. R. Berkley Group	-$155,527	-1.8%
Western World Insurance Group	-$178,449	-30.0%
Average - Surplus Lines Specialsts	**-$76,396**	**-4.9%**
Total P/C Industry	**-$6,740,000**	**-1.6%**

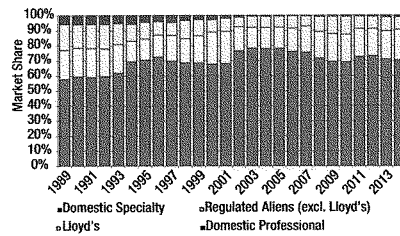
Source: A.M. Best data and research

Exhibit 4
U.S. Surplus Lines - DPW by Segment
(1989-2014)



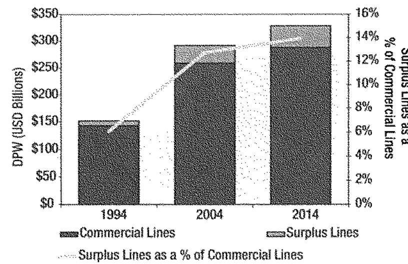
Source: A.M. Best data and research

Exhibit 5
U.S. Surplus Lines – Market Share by Segment
(1989-2014)



Source: A.M. Best data and research

Exhibit 6
U.S. Surplus Lines – Direct Premiums Written vs. Commercial Lines (1994, 2004, 2014)



Source: A.M. Best data and research

have the ability to benefit in forthcoming years and be able to absorb the inevitable fluctuations in loss frequency and severity.

Surplus lines insurers have traditionally applied specialized underwriting to each risk and utilized their freedom of rate and form to serve as a market of last resort. However, A.M. Best has observed an increase of traditional standard market carriers expanding their capacity to write non-standard business with a subsidiary or affiliate structured and designed to operate as a surplus lines company. While none of these companies have enough size to reach the status of a Top 25 surplus lines company (**Exhibit 8**) in terms of direct premiums written many are within striking distance and may reach this level in the coming years as they continue to grow. A handful of these companies are expanding their appetite for nonadmitted business to retain membership within the group or as a diversification play.

For the fourth straight year, domestic professional surplus lines (DPSL) carriers, those writing >50% of their business on a nonadmitted basis, saw their direct premium levels grow. Growth also was seen across other channels when comparing 2014 to 2013 (**Exhibit 4**), notably non-Lloyd's alien companies (this premium is tracked by the National Association of Insurance Commissioners).

Exhibit 6 shows the path surplus lines premium has taken over the last 20 years. Over time, surplus lines premium as a percentage of total commercial lines premium has increased steadily. The proportion seen in 2014 is the highest recorded since first measuring this split.

Further in-depth analysis of surplus lines financial results and measures will be explored in Section II - Financial Condition and Ratings Distribution.

Leading Surplus Lines Companies and Groups

Exhibit 7 encompasses the leading surplus lines organizations, measured on the basis of 2014 direct premiums written. We have already noted that the top position among surplus lines groups in terms of DPW has most recently been held by Lloyd's. The growth in premium written by Lloyd's and the increase in the Lloyd's share of the surplus lines market is a trend that began many years ago. Lloyd's provides a unique platform for partnering with MGAs or for primary insurers looking for reinsurance participants on their surplus lines programs.

Among domestic groups, the largest writer of surplus lines DPW remains AIG, primarily through Lexington Insurance Company. Its direct written premium levels remain near $5.0 billion, a consistent amount over the last five years and reflective of its strengths in the market. AIG has shifted some of its premium production offshore, from Lexington to AIG Europe Limited, a licensed non-Lloyds alien insurance company. This has constrained the total premium captured in the group rankings for the organization, but it is still more than double the surplus lines DPW of the next domestic group. The consolidation of the DPW generated by these two leading groups continues to remain near 30% of the measured surplus lines market.

Most of the composition of the top ten groups remains the same as last year, notably Nationwide Group (through the Scottsdale Insurance Company subsidiary), W.R. Berkley, Zurich Financial, and Markel. These organizations have consistently been among the leaders in surplus lines with long standing relationships and recognizable brand names. There is some shifting among the top groups for 2014 with Ironshore Insurance Group and Berkshire Hathaway accumulating significant gains in premium to reach a top ten position in the market. While Berkshire is making an aggressive run in this space, Ironshore was one of the companies that expected to be acquired by Fosun in 2015.

Exhibit 7

U.S. Surplus Lines – Top 25 Groups (2014)

Ranked by direct premiums written.
(USD Thousands)

Rank	AMB No.	Group Name	Surplus Lines DPW	Total Surplus Lines Market Share (%)
1	85202	Lloyd's	8,157,000	20.3
2	18540	American International Group	4,679,470	11.6
3	05987	Nationwide Group	1,780,987	4.4
4	18252	W.R. Berkley Group	1,485,813	3.7
5	18549	Zurich Financial Svcs NA Group	1,204,753	3.0
6	18468	Markel Corporation Group	1,191,418	3.0
7	18498	ACE INA Group	1,032,388	2.6
8	18728	Ironshore Insurance Group	894,986	2.2
9	00811	Berkshire Hathaway	835,316	2.1
10	03116	Fairfax Financial (USA) Group	793,974	2.0
11	18640	Alleghany Insurance Holdings	780,702	1.9
12	18313	CNA Insurance Companies	745,886	1.9
13	18130	XL America Group	726,916	1.8
14	18603	AXIS Insurance Group	591,135	1.5
15	00012	Chubb Group of Insurance Companies	574,425	1.4
16	18484	Arch Insurance Group	548,931	1.4
17	04019	Argo Group	526,338	1.3
18	18713	QBE Americas Group	522,550	1.3
19	18591	Allied World Group	517,559	1.3
20	04835	Great American P&C Group	472,564	1.2
21	18720	Catlin U.S. Pool	443,724	1.1
22	18604	State National Group	434,505	1.1
23	18783	Aspen US Insurance Group	425,002	1.1
24	18756	Starr International Group	396,987	1.0
25	03262	Swiss Reinsurance Group	378,134	0.9
		Subtotal of Top 25	**$30,141,363**	**74.9**
		Total U.S. Surplus Lines Market	**$40,233,826**	**100.0**

Source: A.M. Best data and research

Exhibit 8

U.S. Surplus Lines – Top 25 Companies (2014)

Ranked by direct premiums written.
(USD Thousands)

Rank	AMB No.	Company Name	Group Name	Surplus Lines DPW	Total Surplus Lines Share (%)
1	02350	Lexington Insurance Company	American International Group	3,780,213	9.4%
2	03292	Scottsdale Insurance Company	Nationwide Group	1,559,064	3.9%
3	03557	Steadfast Insurance Company	Zurich Financial Svcs NA Group	1,051,685	2.6%
4	03535	AIG Specialty Insurance Co	American International Group	899,194	2.2%
5	13866	Ironshore Specialty Ins Co	Ironshore Insurance Group	880,700	2.2%
6	03538	Columbia Casualty Company	CNA Insurance Companies	745,886	1.9%
7	11340	Indian Harbor Insurance Co	XL America Group	726,883	1.8%
8	12515	AXIS Surplus Insurance Company	AXIS Insurance Group	591,135	1.5%
9	04433	Westchester Surplus Lines Ins	ACE INA Group	575,138	1.4%
10	12523	Arch Specialty Insurance Co	Arch Insurance Group	548,931	1.4%
11	02428	National Fire and Marine	Berkshire Hathaway Group	540,747	1.3%
12	12619	Landmark American Ins Co	Alleghany Insurance Holdings	532,764	1.3%
13	02713	Chubb Custom Insurance Co	Chubb Group of Insurance Cos	526,899	1.3%
14	12562	QBE Specialty Insurance Co	QBE Americas Group	522,550	1.3%
15	03283	Colony Insurance Company	Argo Group	522,240	1.3%
16	01990	Nautilus Insurance Company	W. R. Berkley Insurance Group	506,983	1.3%
17	03759	Evanston Insurance Company	Markel Corporation Group	484,732	1.2%
18	02732	Essex Insurance Company	Markel Corporation Group	472,335	1.2%
19	12118	Gemini Insurance Company	W. R. Berkley Insurance Group	467,658	1.2%
20	03510	Illinois Union Insurance Co	ACE INA Group	457,250	1.1%
21	10092	Catlin Specialty Insurance Co	Catlin U.S. Pool	443,724	1.1%
22	03026	Admiral Insurance Company	W. R. Berkley Insurance Group	443,067	1.1%
23	13105	United Specialty Insurance	State National Group	434,505	1.1%
24	12630	Aspen Specialty Insurance Co	Aspen US Insurance Group	425,002	1.1%
25	13977	Starr Surplus Lines Company	Starr International Group	396,987	1.0%
		Subtotal		**$18,536,272**	**46.1%**
		Total U.S. Surplus Lines Market		**$40,233,826**	**100.0%**

Source: A.M. Best data and research

Greater variability is seen further down the top 25 list with a few organizations moving five or more spots up or down. Most member companies experience growth or contraction in direct premium levels as they move into or out of selected lines of business. As always, the counter cyclical nature of the surplus lines market relative to the standard insurance industry leads to a resolute expanding/contracting rhythm for their direct premium. This may launch a group into the top 25, only to see it drop off in later years. A continued trend is the expanded diversity of the market as the population of the top 25 companies shifts. (See **Exhibit 8**.) One ongoing driver is interest from investors for creating new entrants in this market as an investment opportunity is perceived. Another ongoing trend is the advancement of total direct premium, as many of the top 25 group members experienced overall growth in direct premium during 2014. This is a condition of the surroundings as the top surplus lines markets effectively exerted their market influence.

Given the historical trends, it would be a real challenge for any observer to predict how the list of leading companies would look in the near-term future. Although a fair portion of the rankings remain the same from ten years prior (see **Exhibit 9**), constant merger and acquisition activity, start-up companies, and poor operating performance can be expected to add companies to, or subtract them from, the surplus lines market. Even with this dynamic, A.M. Best believes that the top-tier surplus lines insurers, those with a proven track record of favorable operating results, strong balance sheet positions, and supportive market profiles, will retain their position through a combination of disciplined underwriting and product innovation.

Current Challenges

The ability to generate favorable underwriting results is the mainstay of profitability of any insurance company. A.M. Best actively monitors all conditions that impact markets, and as we will note here, certain factors created specific challenges for the surplus lines market participants. Even despite the last two years of strong underwriting profitability, surplus lines companies have been facing tighter operating conditions in order to be able to generate income. These companies continued to serve as a "market of last resort" for the higher hazard classes not served by traditional markets, and that is not expected to change any time soon.

Exhibit 9

U.S. Surplus Lines – Top 25 Groups (2005)

Ranked by direct premiums written.

(USD Thousands)

Rank	Company Name	Surplus Lines DPW	Total Surplus Lines Market Share (%)
1	American Inernational Group	6,977,070	21.0%
2	Lloyd's	4,675,000	14.0%
3	Zurich/Farmers	1,739,701	5.2%
4	ACE INA Group	1,497,092	4.5%
5	Nationwide Group	1,405,160	4.2%
6	W. R. Berkley Group	1,327,155	4.0%
7	Markel Corporation	1,276,579	3.8%
8	Berkshire Hathaway	886,294	2.7%
9	CNA Insurance Companies	814,094	2.4%
10	Arch Capital Group	796,143	2.4%
11	AXIS Insurance Group	630,238	1.9%
12	St. Paul Traveles Companies	599,185	1.8%
13	Argonaut Insurance Group	520,141	1.6%
14	Chubb Group	459,080	1.4%
15	United America Indemnity Group	437,025	1.3%
16	XL America Group	422,740	1.3%
17	RLI Group	390,213	1.2%
18	Great American P&C	367,955	1.1%
19	IFG Companies	361,291	1.1%
20	Hartford Insurance Group	355,823	1.1%
21	HCC Insurance Holdings Group	349,238	1.0%
22	Fairfax Financial (USA) Group	325,082	1.0%
23	HDI U.S. Group	306,218	0.9%
24	Western World Insurance Group	275,104	0.8%
25	Allianz of America	256,797	0.8%
	Subtotal	**27,450,418**	**82.5%**
	Total U.S. Surplus Lines Market	**33,280,702**	**100.0**

Source: A.M. Best Co. Report *Annual Review of the Excess & Surplus Lines Industry*, September 2006

As more companies enter the arena, either as start-ups, reinsurers dropping down to working layers, or standard carriers expanding their appetite and tolerance, competition will likely increase on price, distribution, risk management, and client services. Even with the surplus lines market's freedom of rate and form, a portion of the market's capacity is restricted by price sensitivity and unable to advance price corrections without a loss of market share, or for various reasons, still have operations conducted on an admitted basis. The discussion of the investment environment and the adverse impact it is having on the insurance industry has become repetitive. Almost every company across the industry has been forced to evaluate their portfolios and make tough choices to allocations, strategies, and risk / return tolerances. The surplus lines carriers are in this same boat and making the same choices. One area on which A.M. Best has already commented in separate special reports and webinars is diversification within investment portfolios focused on Schedule BA assets, hedge funds, private placements, and 144A holdings. Best has observed an increase in these assets in investment portfolios of surplus lines carriers to a level similar with the overall industry.

Concerns of where to invest "new money" and expectations of depressed future treasury yields are factors cited by insurance executives when discussing investment allocation decisions away from traditional assets. The analysis of investment risk will always have a comprehensive review of portfolio risk. Nonetheless, A.M. Best is alert to the modifications in investment risk tolerances and will take a deeper dive when necessary. Furthermore, in Best's Capital Adequacy Ratio (BCAR) analyses, more emphasis will be placed on understanding the risk parameters of these vehicles and significantly higher capital risk factors may be applied on the amounts allocated to these investments.

The surplus lines market typically receives credit for being ahead of the curve on innovation. As noted in prior special reports on this market, exposures such as technological advancements, environmental liability, and cyber risks are areas where surplus lines carriers have been able to meet the needs and demands of the markets. Underwriting discipline and sophisticated pricing models allow carriers to design and develop products providing appropriate coverage. The ability to advance these differentiating products continues to benefit this niche as the next generation of new exposures develops.

The greatest challenge to an individual surplus lines carrier may be retaining its market share. Since a fair portion of this business comes from brokers, surplus lines business is generally shopped each year to some extent, resulting in lower policyholder retention. As a group, surplus lines carriers have focused on improving retention via technology, better broker relationships and enhancing their underwriting analytical capability. This leads to a consistently competitive environment for retention. As one carrier tightens its risk appetite and deems certain types of exposures to be outside of its preferred risk profile, another may reach the conclusion it has the expertise and capability for that same risk.

In an effort to retain market share, some surplus lines organizations have enhanced their network through acquiring renewal rights or establishing new MGAs. Another area of concern for traditional surplus lines carriers is the fact that new entrants and new parents of existing players are likely to create even more competition. Additionally, reinsurers have made moves to "drop-down" into primary layers. Also, new start-up companies, often financed by private equity looking for investment opportunities, can threaten the market share of established surplus lines insurers. The diversification and expanded capacity in the market is expected to continue to drive investment by current incumbent market leaders in their own systems, capabilities, and core competencies in order to retain their positions in this market.

The Lloyd's Market

Lloyd's has been active in the United States since the late 1800s. As the top writer of nonadmitted business from 2010 through 2014, it plays an extremely important role in the surplus lines market. The United States continues to be Lloyd's biggest market, with surplus lines and reinsurance activities generating the majority of Lloyd's U.S. sourced revenues. Risks underwritten by Lloyd's vary considerably, encompassing both property and liability loss exposures. With roughly $8.2 billion in DPW in 2014, Lloyd's represents approximately 20.3% of the surplus lines market.

Over the past decade, Lloyd's surplus lines premium volume has grown from increased marketing activity, new agency appointments, risk-bearing affiliates of syndicates, and the enhanced awareness of Lloyd's security ratings among buyers and producers. Lloyd's surplus lines premium continues to exceed the combined premium levels of its U.S. reinsurance and direct business. Overall, A.M. Best believes Lloyd's will continue to maintain its substantial participation in the U.S. surplus lines market, despite the volatile earnings inherent in surplus lines business.

Mergers & Acquisitions

The insurance industry appetite for mergers and acquisitions continues to make news headlines. Surplus lines carriers may not be the primary source of this news, but they are making waves. One such extremely noteworthy item is the continuing narrative of AXIS Capital Holdings Ltd., the ultimate parent of AXIS Surplus Insurance Company, which as of 2014, was the 14th largest surplus lines carrier. A transaction that would combine AXIS Capital with PartnerRe Ltd. was initially announced January 25, 2015. Subsequent involvement in the bidding for PartnerRe by Exor S.p.A. led to ongoing negotiations, court activity, and a delay in the initial merger proceedings moving forward. On August 3, it was announced that Exor had won the bid to acquire PartnerRe for $6.9 billion of $140.50 per share. A.M. Best will continue to monitor developments relative to this announced purchase.

Likewise, on July 1, 2015, it was announced that Ace Ltd. will acquire Chubb Corporation in a transaction valued $28.3 billion. Both of these organizations derive significant levels of their direct premium from the surplus lines market.

Activity that has already reached completion in 2015 included XL Group plc closing its deal to take ownership of Catlin Group Limited. This acquisition was announced January 1, 2015, and subsequently closed May 1, 2015. This consolidation of two members of the top 25 U.S. surplus lines groups has had an impact on the market, including narrowing the field and dispersing talent.

HCC Insurance Holdings, Inc. (HCC) announced in October 2014 and closed on January 1, 2015 their acquisition of Producers Ag Insurance Group from CUNA Mutual Group. Though crop insurance is not written on a surplus lines basis, many large insurers and reinsurers have been interested in crop insurance due to its product specialization, technology and the benefits afforded through government support and subsidies. The Producers Ag acquisition further strengthened HCC's product and earnings diversification. In a transaction announced June 10, 2015, Tokio Marine Holdings, Inc., through its subsidiary Tokio Marine & Nichido Fire Insurance Co., Ltd., is acquiring HCC for a total of $7.5 billion. Tokio Marine's purchase of a U.S. based property casualty insurer marks its second big splash since acquiring Philadelphia Consolidated Holding Corp for $4.7 billion in late 2008.

Another transaction first announced late in 2014, after the publication of the 2014 surplus lines report, involved Meadowbrook Insurance Group (Meadowbrook). In July 2015, Meadowbrook was acquired by Shanghai based investment group, Fosun International Ltd. In a separate deal announced in May 2015, Fosun announced its plans to acquire the remaining interest in

Stamping Offices Report Growth in Surplus Lines Premium

According to information compiled by the Surplus Lines Stamping Office of Texas, the 14 states maintaining stamping offices reported a 7.6% increase in premium volume during 2014, compared with a 16.0% increase in premium volume in 2013. However, part of the large increase in 2013 reflected a constriction of growth in 2012 due to a large amount of prior years' return premium transactions processed in New York.

Likewise, the stamping offices reported a 6.9% increase in the number of documents filed: 3.4 million in 2014, compared with 3.2 million in 2013. The document count indicates the number of policies and endorsements handled by the various stamping offices. A change in document count provides a rough estimate of the flow of business into and out of the surplus lines market.

The stamping offices only report on 14 states, and the results are influenced heavily by four states — California, Florida, New York and Texas. California generated the highest premium volume of these states, consistent with its ranking in 2013. California recorded the second highest increase in premium during 2014 versus 2013. Only Utah recorded a higher increase at 18.8%. By document count, the leading states continue to be Florida and Texas.

Through the first six months of 2015, the reported document count reveals an increase of 5.3%, compared with an increase of 9.5% in the same period of 2014. Premium growth during the first six months of 2015 was 9.5%, up from the 4.8% increase in 2014. California showed the strongest growth and highest premium volume.

The increase in premium by state exceeding the increase in the number of items processed reflects the underwriting discipline and adherence to adequate pricing in the surplus lines market, which A.M. Best believes will continue at least through the end of 2015.

Ironshore Inc., for $1.84 billion. These transactions further enhance Fosun's plans to build out its insurance business globally.

In a relatively minor transaction, Assurant Inc., one of the smaller surplus lines market participants, streamlined its organization with the sale of American Reliable Insurance Company to Global Indemnity. This transaction will allow Global Indemnity to expand into complementary surplus lines of business and achieve certain economies of scale.

Shortly after the publication of this special report last year, the acquisition of Western World by Validus was completed. This acquisition represented another clear example of a recognized reinsurer making a bold move into the U.S. surplus lines arena.

The next transaction cannot be predicted; however, it is almost a certainty that there will be additional mergers or acquisitions within the surplus lines market in the near term. Capital needs to be allocated where it will create favorable returns for appropriate risks. Across the industry, the option for entering or strengthening a position within a business line is moving into a more prominent position in the market, especially for those with a strong balance sheet position. Add to this the challenge of depressed returns on investments and the result is a continuing appetite for merger and acquisition activity.

A.M. Best's View of the Surplus Lines Market

The state of the surplus lines market through the remainder of 2015 is viewed to be stable. This view takes into consideration continued modest economic improvement, GDP growth of approximately 3%, moderate loss cost inflation between 2 to 4% and an incremental rise in interest rates in the range of 250 to 350 basis points by year end 2015. Equally important, this view assumes some degree of price discipline on the part of surplus lines insurers and to some extent, similar behavior from standard market insurers. A.M. Best believes that today's prevailing low interest rate environment will help to keep aggressive pricing on the sideline. This perspective also anticipates a continuation of favorable prior year reserve releases albeit at a lesser pace.

Using an average return on investment of 5%, A.M. Best believes that surplus lines insurers in the aggregate should be able to sustain a rate of return on equity at or greater than 10% in 2015. This assumes a combined ratio of 90% to 95%, attritional loss ratio between 60% to 65% and non-attritional losses of 5% including storm activity. This also assumes the continued benefit of favorable prior year reserve development.

A.M. Best views the surplus lines market as stable from a ratings perspective and expects that the vast majority of surplus lines insurers will have their ratings affirmed. While this is our general view of the market, many conditions, such as underwriting profitability, competition, new products, investment returns, and reserve development, will affect our analysis of each company operating in this line.

Over the last ten years, the surplus lines sector recorded seven years of underwriting profit, with the exception being three consecutive years from 2010 through 2012. A.M. Best expects 2015 to be another fruitful year of underwriting profitability for this niche.

We have observed that despite all of the challenges, carriers in general are maintaining pricing discipline. Our perspective for an upbeat 2015 also contemplates three points of catastrophe losses in the year - a point impact similar to the assumption used in our forecast for commercial lines insurers. It should be noted that surplus lines carriers, by nature of the specialized business and risk appetite, will remain exposed to large losses such as natural catastrophes and terrorism events. Weather-wise, the hazard comes from a variety of events

(hurricanes, tornadoes, polar vortex), but the prudent carriers remain forefront as they monitor the risks. Terrorism exposures also continue to be a primary concern. Advances in risk assessment, use of standard reinsurance, and passage of TRIPRA 2015 (discussed in detail later in this report) partially mitigate this concern. Regardless of the extent that the impact of these events on a book of business can be minimized, their occurrence patterns may be less predictable than ever. That noted, models, TVAR calculations, and PML accumulation monitoring are necessities for day-to-day decisions.

Another key element in surplus lines carrier operations is the extensive commitment to develop and implement more sophisticated technology. These measures already are proving valuable in interfacing with producers in an efficient manner, parsing volumes of data to identify desirable risks versus problematic ones, tracking underwriter and producer success, and actively monitoring risk accumulations on a highly defined level. It is getting to the point that if an insurer is not taking effective advantage of these capabilities, it likely will be fighting an uphill battle for relevance and viability in the surplus lines markets.

Successful surplus lines carriers are those whose boards and management teams have been able to apply strategic options to turn threats into opportunities. Application of underwriting capability to reverse poor experience in a highly specialized line is just one example of turning the tables on perceived weaknesses in a business profile. One way to assess this is implementation of a risk appetite and tolerance statement. A.M. Best began requesting these from all insurance carriers through the 2014 Supplemental Rating Questionnaire distributed during the first quarter of 2015. Organizations that have the ability to clearly and succinctly state and implement these measures will be in a better position to retain or enhance their positions in the surplus lines market. Even with all of these items, the expectation of surplus lines carriers and their long term success remains grounded in key factors: freedom of rate and form, ability to maintain price integrity, a focus on bottom line stability, balanced risk / reward tolerance levels, strong investment returns, and enterprise risk management capability exceeding risk profiles.

Conclusion

Through the first half of 2015, overall market conditions remain comparable with 2014, demonstrating ongoing competition, low interest rates and limited weather related events. With persistently low interest rates providing only marginal investment returns, underwriting performance remains as the leading driver of operating performance. Total investment income from both traditional and higher yielding asset classes are needed to provide additional support to income and surplus.

The core competencies of the successful surplus lines carriers remain the same, focused on effective strategic analysis, product diversification and underwriting discipline. Advantageous market conditions and an environment conducive to opportunistic mergers and acquisitions only further benefit the strong carriers. Competition continues to expand in this market either through affiliated companies, new entrants or M&A activity. Even with the best ability to focus on their own performance, surplus lines carriers remain exposed to external factors, such as economic conditions and judicial or regulatory concerns that can and will interfere with daily operations and financial success.

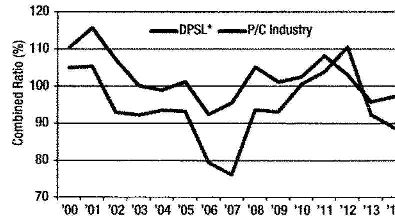
Historically, the best surplus lines insurers have focused on maintaining the underwriting and pricing integrity that have been the hallmark of this market segment. These companies typically focus more on bottom-line profits than top-line organic growth, utilizing the segment's freedom of rate and form, while providing coverage for the varied, nonstandard risks that they underwrite. This focus gives these insurers the best chance to withstand adverse market circumstances and succeed over the long term. A.M. Best expects surplus lines insurers to concentrate on using proven fundamentals to overcome the execution risk presented by current and future underwriting and investment market conditions.

Section II – Financial Condition and Rating Distribution

In the past, A.M. Best was able to report with near certainty the surplus lines premium volume written by the 73 companies that make up the Domestic Professional Surplus Lines (DPSL) composite. (See sidebar, *A.M. Best's DPSL Peer Composite Defined.*) However, as the industry advances, multiple admitted and non-admitted specialty carriers have been established within the same group. With these, risk-sharing tools such as pooling agreements and internal reinsurance programs have been employed, blurring the statutory reporting lines between the segments and their related data.

For example, on January 1, 2014, Lexington Insurance Company expanded their pooling agreement with more entities from across numerous AIG segments, mixing standard and surplus lines business into a homogenous pool shared among the participants. Though this strategy is not unprecedented, the magnitude of the agreement has led to an extraordinarily substantial impact on the surplus lines premium data for 2014. In particular, during 2013, Lexington Insurance Company assumed $1.6 billion in premium. With its new pooling agreement, the amount of the company's assumed premium increased almost 550%, to $10.2 billion. As Lexington is a component of the DPSL composite, those results also were impacted with an increase in assumed premium from $4.9 billion in 2013 to $12.6 billion in 2014. Though partially offset by the sharp increase in ceded premiums ($11.2 billion in 2014 from $8.5 billion in 2013), the effect on the composite's net written premium was still substantial, increasing 20% to $10.6 billion from $8.8 billion in 2013.

Exhibit 10
U.S. DPSL* – Combined Ratios vs. U.S. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

A.M. Best's DPSL Peer Composite Defined

The analysis in this section is based on the statutory financial data of the 73 U.S.-based domestic professional surplus lines (DPSL) companies. The DPSL composite produced approximately $15.9 billion in direct premiums written (DPW) in calendar year 2014, representing approximately 39.5% of the total U.S. DPSL market as defined in this report.

DPSL companies are identified as those that write at least half of their business on a nonadmitted basis. These organizations historically have accounted for approximately two-thirds to three-quarters of the total surplus lines market.

To determine the population of true DPSL companies for the purpose of this section and the comparisons herein, A.M. Best excludes surplus lines companies that are members of intercompany pools that predominantly write admitted business as opposed to surplus lines business; those companies that reinsure all of their business with an affiliate, and companies that write a relatively small amount of premium. The DPSL composite, however, does include companies that may be part of an intercompany pool, but still write surplus lines business predominantly on a direct basis and retain a substantial portion of this business.

As the lines between classes of business become less clear, operational and strategic changes made by the larger players in the industry will inevitably alter the juxtaposition of data between periods.

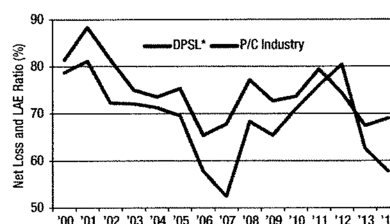
DPSL Peer Composite Overview

A.M. Best's domestic professional surplus lines (DPSL) composite is a consolidation of 73 U.S.-based DPSL companies committed to the surplus lines space and provides a good indication as to the health of the surplus lines sector. In 2013 and 2014, direct written premium for this composite grew at 3.5% and 3.3%, respectively. As for net written premiums, growth in 2014 was 19.9%

Similar to the segment's performance in 2013, the DPSL composite continued to outpace the operating and underwriting results posted by the P/C industry in 2014. Benefiting from another benign catastrophe year in 2014, the composite posted loss ratios below the prior year in most lines of business, which helped achieve the lowest overall loss and LAE ratio since 2007. (See **Exhibit 11**.) Also helping to sustain underwriting profits in 2014, was the steady increase in direct premium writings, supported by exposure and rate growth.

Notwithstanding the companies' consistently profitable performance, the composite still struggled in 2014, with low investment yields and continued excess capacity. The sharp decline in investment yields was the result of an increased asset base but with a decrease in investment income, driven by the low interest rate environment. This occurred despite an increase in common stock allocations that provided an opportunity for diversification.

Exhibit 11
U.S. DPSL* - Net Loss & Loss Adjustment Expense Ratios vs. U.S. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Operating Performance

The DPSL composite continues to clearly outpace the underwriting and operating results of the total P/C industry, as evident in the composite's 99.0 and 99.3 five- and ten-year combined ratios, compared with 101.2 and 101.1, respectively, for the total P/C industry. (See **Exhibit 10**.) It's important to note, also, that the composite's combined ratios in 2013 and 2014, at 92.4 and 88.8, respectively, were well below their five- and ten-year averages and the total P/C industry's combined ratio in those years. Furthermore, the DPSL composite posted lower combined ratios than the total P/C industry in nine out of the last ten years, though the difference between the two has narrowed.

The impact on surplus lines insurers' underwriting profitability from prior years' weather-related losses has lessened, since the segment's innate exposure to catastrophe-prone risks hasn't been taxed since the storms of 2012. The lack of significant weather-related events in 2014 boosted the underwriting performance by tempering the composite's pure loss ratio to 44.7, its lowest level in over five years. This compares very favorably to the total P/C industry's 2014 loss ratio of 57.2. The underwriting controls and pricing discipline exhibited throughout the surplus lines market ensures the continuity of secure capitalization levels moving forward.

The DPSL composite's operating ratio still compared favorably to that of the total P/C industry in 2014, at 72.3% compared to 86.1%, though the gap between the two narrowed from 2013

(13.8 pts. vs. 19.8 pts.). This reduced spread is attributed to the composite's diminished net investment ratio of 16.5% compared to 26.8% in 2013, with both an increased premium base and a 26% decline in investment income driving this trend. Nonetheless, 2014 marked the composite's second best operating performance since 2007 (2013 was the best), which is a testament to the strength and consistency of the surplus lines segment.

Posting the second-straight year of underwriting profitability, the composite was well-positioned to offset the decline in investment income with underwriting performance. Pretax operating profits in 2014 rank well historically, as higher operating profits were only seen in four of the last ten years, one of which was 2013. The step back from 2013 levels was caused by the decline in investment income. Mirroring the operating profitability, the composite's net income remained strong at $2.8 billion, a moderate 17% decline from 2013's near-record level.

Though net income through the composite was strong in 2014, essentially none was passed through to policyholder surplus, as surplus levels dropped 1.7%. The stockholder dividends paid out more than offset the favorable net profitability, which indicates strong capitalization and optimism throughout the segment. This dip in surplus levels contrasts with the total P/C industry's 3.4% increase.

Despite this disparity in surplus growth, the DPSL composite's pretax returns outperformed the total P/C industry by a strong margin. (See **Exhibit 14**.) Reflecting the prior ten years, the 2014 DPSL composite exceeded the total P/C industry's total return on revenue at 32.3% and 14.0%, respectively, and total return on equity at 14.8% and 10.1%, respectively. This favorable trend has persisted throughout even the high catastrophe event years, evident of the surplus lines segments emphasis on strong underwriting controls, superior capital position, risk selection and diversification, as well as operating efficiency.

Net Investment Gains

The DPSL's net investment income again reversed course in 2014, falling 26.1% after increasing by 11.0% in 2013. (See **Exhibit 12**.) However, the overall P/C Industry recognized the opposite result, increasing 11.5% in 2014 and falling 1.1% in the previous year. For the fourth straight year, the DPSL composite increased its total stock allocation, now approaching $10.9 billion, whereas the bond allocation has declined since 2011, and now stands at $31.1 billion. The increase in stock allocation is also supported by a diminishing cash and short-term investment allocation, now a mere 5.7% of total admitted assets throughout the composite. Generally, the trend of increasing stock allocation is also evident in the total P/C industry, although to a slightly lesser degree. Of course, this increase in "stock allocation" was driven, in part, by the appreciation in the market value of these assets over the last few years.

Exhibit 12

U.S. DPSL* Composite – Investment Performance vs. P/C Industry

(USD Billions)

	DPSL * 2013	DPSL* 2014	Year/Year Change (%)	Total P/C Industry 2013	Total P/C Industry 2014	Year/Year Change (%)
Net Investment Income	2,357	1,741	-26.1	49,501	55,179	11.5
Realized Capital Gains or (Losses)	554	843	52.2	12,141	12,086	-0.5
Net Investment Gain	2,911	2,584	-11.2	61,642	67,265	9.1
Unrealized Capital Gains or (Losses)	865	563	-34.9	38,611	4,215	-89.1
Total Investment Return	3,776	3,147	-16.7	100,253	71,480	-28.7

*Domestic Professional Surplus Lines
Source: A.M. Best data and research

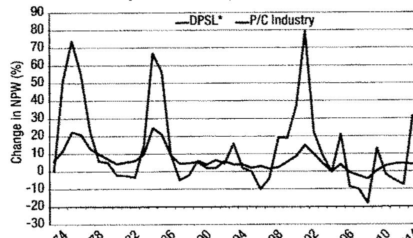
In 2014, the composite's realized gains of $843 million and unrealized gains of nearly $563 million on investments softened the decline in total investment return to 8.5% when compared to 2013. The P/C industry experienced a more pronounced (approximately 29%) decline in its total investment return, which was driven by below-average unrealized capital gains.

Favorable Loss-Reserve Development

Throughout the past few years, favorable prior-year loss-reserve development has boosted the overall P/C industry's underwriting profitability. Likewise, favorable reserve development reduced the DPSL composite's loss ratio by 3.6 points in 2014, though less than the 8.5 points in 2013. Mirroring the DPSL composite, the overall P/C industry recognized a 1.9 and 3.6 point reduction in 2014 and 2013, respectively.

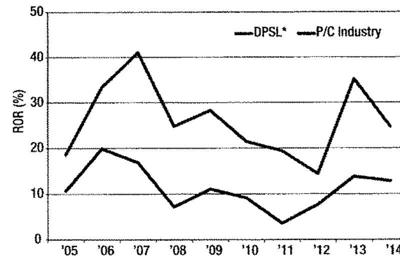
These findings are consistent with A.M. Best's perspective that although the favorable reserve development is supporting underwriting profitability, the magnitude of the support is declining and will continue to dissipate. Commercial auto insurers are already realizing rapidly rising adverse reserve development throughout the P/C industry, while the DPSL composite companies are seeing adverse development across several lines. One main driver of this trend is the ongoing reserve margin tightening amongst surplus lines insurers, reflective of patterns within the overall industry. Insurers that have reserved conservatively will continue to benefit from reserve redundancies and will be better positioned to take advantage of market opportunities through the cycle as others are forced to recognize reserve redundancies, leading to eroding underwriting results and surplus positions.

Exhibit 13
U.S. DPSL* Composite vs. P/C Industry – NPW Growth (1974-2014)



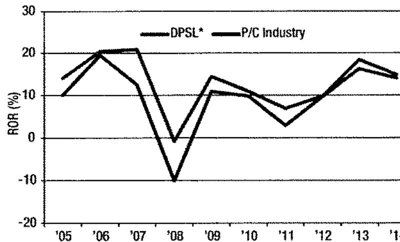
* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Exhibit 14
U.S. DPSL* - Pretax Returns on Net Premiums Earned (NPE) vs. U.S. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Exhibit 15
U.S. DPSL* – Total Returns on Surplus vs. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

DPSL's Growth Rate Less Than Total P/C Industry's

As mentioned earlier, much of the net growth experienced in the DPSL composite in 2014 is connected to the new pooling arrangement of Lexington Insurance Company and AIG. (See **Exhibit 13**.) However, the direct premium writings were unaffected by this arrangement and may serve as the best metric to determine growth throughout the sector. In 2014, the DPSL composite saw direct premium writings increase 3.3%, slightly trailing the overall P/C industry growth of 4.5%. This is the fourth straight year of DPW growth.

Net premium written for the DPSL composite grew 31.3%, compared to the more modest 4.1% growth in the P/C industry. Without the support of Lexington's new pooling arrangement, A.M. Best estimates that NPW growth in the DPSL composite would have been flat, if not slightly negative. The evidence supporting this estimate is the higher growth rate of ceded premiums (12.3% CAGR) compared to gross premiums (9.2% CAGR) over the past five years. As companies take advantage of less expensive reinsurance and continue to optimize their reinsurance placements, this trend likely will continue. It is important to note, however, that a similar trend is occurring throughout the entire P/C industry (3.6% and 3.9% five-year CAGR for gross and ceded premiums, respectively), though to a lesser degree.

Balance Sheet Strength

Given the uniquely hazardous risks that surplus lines companies insure, it is particularly important for these companies to maintain very strong balance sheets. Historically, these insurers have generally

Exhibit 16

U.S. DPSL* - Best's Rating Distribution by Rating Unit vs. U.S. P/C Industry

Best's Financial Strength Rating (FSR)		Domestic Professional Surplus Lines		Total P/C Industry	
Level	Category	# of Rating Units	Percentage	# of Rating Units	Percentage
RATINGS					
A++	Superior	8	8.79	24	2.75
A+	Superior	21	23.08	81	9.28
	Subtotal	**29**	**31.87**	**105**	**12.03**
A	Excellent	43	47.25	290	33.22
A-	Excellent	18	19.78	285	32.65
	Subtotal	**61**	**67.03**	**575**	**65.86**
B++	Good	1	1.10	94	10.77
B+	Good	0	-	59	6.76
	Subtotal	**1**	**1.10**	**153**	**17.53**
Total Ratings		**91**	**100.00**	**833**	**95.42**
FAIR & BELOW RATINGS					
B	Fair	0	-	25	2.86
B-	Fair	0	-	7	0.80
	Subtotal	**0**	**-**	**32**	**3.67**
C++	Marginal	0	-	1	0.11
C+	Marginal	0	-	3	0.34
	Subtotal	**0**	**-**	**4**	**0.46**
C	Weak	0	-	3	0.34
C-	Weak	0	-	1	0.11
	Subtotal	**0**	**-**	**4**	**0.46**
D	Poor	0	-	0	-
E	Under Regulatory Supervision	0	-	0	-
F	In Liquidation	0	-	0	-
	Subtotal	0	-	0	-
Total Fair & Below Ratings		**0**	**-**	**40**	**4.58**
Total Rating Opinions		**91**	**100.00**	**873**	**100.00**
Total NR Ratings		**4**		**970**	
Total Reported Rating Units		**95**		**1,843**	

*Domestic Professional Surplus Lines
1 Domestic professional surplus lines ratings are as of August 11, 2015
2 Total industry ratings distribution data is as of June 26, 2015
Source: A.M. Best data and research

remained very well capitalized and have continued to maintain this strength through 2014, providing flexibility in the quickly-evolving surplus lines sector.

Exhibit 17
DPSL Peer Composite – Top 5 Product Lines (2014)
Ranked by direct premiums written.
(USD Thousands)

Rank	Product Line	Surplus Lines DPW	DPSL Peer Composite Market Share (%)
1	Other Liability	7,333,953	46.1
2	Fire	1,844,219	11.6
3	Allied Lines	1,565,946	9.8
4	Commercial MultiPeril	1,016,829	6.4
5	Inland Marine	948,412	6.0
	Subtotal of Top 5	**12,709,359**	**79.9**
	Total DPSL Peer Composite	**15,909,089**	**100.0**

Note: "Other Liability" consists primarily of commercial occurrence and claims made general liability policies.
Source: A.M. Best data and research

In 2014, the DPSL composite's policyholder surplus declined by 1.7%, despite generating $2.8 billion in net income. Though reinforced by unrealized capital gains, bringing the composite's total return to $3.4 billion, these earnings were more than offset by $3.2 billion in dividends to holding companies to support stockholder dividends and share buybacks.

By comparison, in 2013 the P/C industry and DPSL composite both experienced turnaround years, generating a 68.7% and 120.4% increase in net income, respectively. Despite this immense growth in the DPSL composite, policyholder's surplus declined 1.2%. A.M. Best believes this speaks to the segment's balance sheet strength, as these companies have capitalized themselves well enough to pay dividends on their earnings.

The DPSL composite continues to maintain generally lower leverage than the total P/C industry, with the exception of ceded leverage, which is slightly higher than the P/C industry average. Despite the marginal difference in ceded leverage, the use of affiliated reinsurers by the composite and total P/C industry are comparable at 86.2% and 85.0% of premiums, respectively. The composite's net leverage of 2.0 times surplus registers a shade below the total industry average of 2.3 times surplus. Because of the DPSL composite's slightly higher ceded leverage of .8 times surplus compared to the industry average of .5 times surplus, the two have equivalent gross leverage of 2.8 times surplus.

Further supporting the composite's strong risk-adjusted capitalization is its conservative investment portfolio, with U.S. government and NAIC Class 1 bonds still constituting the vast majority of the portfolios. Likewise, durations consciously are being kept short in anticipation of an eventual rise in interest rates.

Section III: Regulation and Legislation

One of the first acts of the 114th Congress was the passage of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA) to reinstate the federal Terrorism Risk Insurance Program, which expired December 31, 2014. (See **Exhibit 18.**) President Obama signed TRIPRA into law on January 12, 2015, extending the federal terrorism program until December 31, 2020. Key revisions to prior provisions included:

- Federal share reduces from 85% to 80% (1% per year)
- Program trigger increases from USD 100 million to USD 200 million (USD 20 million per year)
- Industry's aggregate retention increases from current USD 27.5 billion to USD 37.5 billion (USD 2 billion per year) and Treasury's recoupment rate increases from 133% to 140%.

Exhibit 18

Federal Terrorism Backstop

Terms	TRIPRA (Previous Program)	TRIPRA Reauthorization Act of 2015 (H.R.26, Current Program)
Status		Enacted into law
Extension	NA	5 years to December 31, 2020.
Co-Participation	15%	Beginning on January 1, 2016, Co-Participation will increase 1% annually to 20%
Deductible	$27.5 billion	$27.5 billion, increasing annually by $2 billion to $37.5 billion in the year 2020.
Trigger	$100 million	$100 million, rising by $20 million to $200 million by 2020.
Recoupment	133%	Increase from 133% to 140%
Timeline for Certification	Not Specified	5 years

Source: A.M. Best research
Terrorism Risk Insurance
Program Reauthorization Act (TRIPRA) of 2015 and the Flood Insurance Reform Act, are measures that would reauthorize and modify existing federal programs.

The TRIPRA extension also included the long-anticipated adoption of the National Association of Registered Agents and Brokers (NARAB II). The insurance industry lobbied many years for NARAB in an effort to streamline the licensing process for agents and brokers nationwide and eliminate burdensome multistate requirements while preserving important state regulatory authority and consumer protections in nonresident licensing. NARAB will not become operational until the President appoints a Board, which must be confirmed by the Senate. The Board will consist of eight regulators and five industry members, with three of the industry members representing the P&C industry. After establishing the Board, it is expected to be one to two years before NARAB issues its first national license as the Board is tasked with adopting rules and requirements for internal operations and licensing. Although this is a federally created Board, the states maintain their regulatory and disciplinary authority.

The chart below summarizes recent federal and state legislative and regulatory proposals that could affect the surplus lines industry.

2014-2015 Federal Legislation/ Regulation

Bill/Sponsor	Key Provisions & Actions
Terrorism Risk Insurance Program Reauthorization Act (TRIPRA)	Before September 11, 2001, insurance coverage for losses as a result of a terrorist attack was included in general insurance. After the attacks, such coverage became very expensive, if offered at all. Congress responded to this disruption by passing the Terrorism Risk Insurance Act of 2002, providing a government reinsurance backstop so commercial insurers would offer terrorism coverage. The lack of available insurance caused fears of a major impact on the economy, as companies would remain idle due to uncertainty. The act – extended and amended in 2005 and 2007 and now known as the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) – expired on December 31, 2014.
H.R. 26 TRIP Reauthorization Act of 2015 (Current Program)	On January 12, 2015, President Obama signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2015, which extends TRIP to December 31, 2020 and revises several features of the previous program. Beginning January 1, 2016,The federal share of payments will be reduced by 1% annually to 80% of insured losses from acts of terrorism. The Aggregate industry insured loss trigger will increase stepwise from $100 million in 2015 to $200 million for 2020 and requirements for mandatory recoupment from insurers receiving federal financial assistance will be revised; the recoupment threshold increases $2 billion annually, up to $37.5 billion, and then by a specified formula, while the terrorism loss risk-spreading premium increases from 133% to 140%. Finally, a recoupment in case uncompensated losses surpass aggregate market retention totals is now mandatory. Improvements to the program under this act include the requirement of both the Secretary of the Treasury and the Secretary of Homeland Security to certify an "act of Terrorism", tasking the Secretary of the Treasury to study and issue final rules governing the process for certifying an act of terrorism, and assignment of the GAO to study federal assessment and collection of upfront premiums and the creation of a capital reserve fund to house prepaid capital. The Act calls for the appointment of at least one member to the Board of Governors of the Federal Reserve, experienced with community banks having less than $10 billion in assets, the appointment of an advisory committee to facilitate the creation of non-governmental risk-sharing mechanisms to support private market reinsurance capacity, specific congressional information and reporting requirements for participating insurers, as well as biennial study on the competitive challenges facing small participating insurers.
H.R. 26, Title II National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II)	The National Association of Registered Agents and Brokers (NARAB) Reform Act of 2015 was enacted on January 12, 2015 as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. NARAB will streamline agent and broker licensing for those operating on a multi-state basis. It creates a nonprofit board governed by a panel of state insurance regulators and industry representatives to create rigorous standards and ethical requirements with a goal of applying licensing, continuing education and nonresident insurance producer standards on a multi-state basis. With a focus on nonresident licensing, agents or brokers applying for a national license through NARAB will first be required to hold a current license in their home state, pass a national criminal background check and meet the criteria established by the Board, which shall include standards for personal qualifications, educational training and professional experience. The President, with the advice and consent of the U.S. Senate, will appoint the 13 Board members (8 regulators and 5 industry members). Before becoming operational, the board must first establish the rules, requirements and procedures, as well as a national licensing clearinghouse. NARAB is not expected to become operational for a while, with most observers believing it will most likely happen in about two years. • Title II establishes NARAB without contingencies, prohibits NARAB from merging or operating as an insurer/producer, establishes presidential oversight of the NARAB, precludes Federal Funding of NARAB, and also establishes criteria for the board of directors, as well as operational parameters. The Act maintains NARAB's state regulatory jurisdiction regarding consumer protection, market conduct, and state disciplinary authority. • Title II grants NARAB disciplinary enforcement powers, and requires NARAB to establish procedures for multi state qualifications and oversight of non-NARAB insurance producers. • Title II directs NARAB to establish fairness and eligibility criteria and standards to join and maintain membership with NARAB, including criminal history record checks.

• Title II prescribes procedures for authorized and required information sharing for both NARAB and its members, establishes authorized business practices based on NARAB membership, equivalent to a nonresident insurance producer license, establishes continuing education requirements for members by sources other than NARAB, as well as consumer complaint management.

• Finally, Title II authorizes civil action by aggrieved individuals resulting from a NARAB decision or action, and minimally preempts state laws that regulate insurance producers.

Bill/Sponsor	Key Provisions & Actions
Flood Insurance Reform Act of 2012	The Biggert-Waters Flood Insurance Reform Act of 2012 was passed by Congress and signed by the President in 2012. It extended the National Flood Insurance Program (NFIP) for five years, while requiring significant program reform.
The following bills were introduced in the 113th Congress in:	Concern about increased premium rates resulting from Biggert-Waters caused Congress to reconsider its implementation. The House and Senate ultimately both passed bills to reverse some of the changes brought about by Biggert-Waters.
October 2013:	
H.R. 3370, by Rep. Michael Grimm (R-NY)	H.R. 3370, the Homeowner Flood Insurance Affordability Act of 2014, required the NFIP to consult with "Write Your Own" companies on rate tables, capped the annual increase for the chargeable risk premium rate for flood insurance to 18% (with some exclusions), and required an increase in the chargeable flood insurance risk premium rates for certain properties. It directed FEMA to minimize the number of policies with annual premiums exceeding 1% of the total policy coverage, imposed an annual premium surcharge, beyond existing assessments and surcharges, on new or renewed policies, and draft a framework that addresses flood insurance affordability, via programmatic and regulatory change. This legislation was signed into law in March 2014. Finally, H.R. 3370 required a review of the NFIP flood mapping program to ensure accurate flood hazard data.
March 2014:	
H.R. 4313, by David Jolly (R-FL)	H.R.4313, the Flood Insurance Premium Parity Act of 2014, amended the National Flood Insurance Act of 1968 (NFIA) to prohibit the Administrator FEMA from estimating reduced (subsidized) risk premium rates for flood insurance for residential property that is neither the primary residence of an individual (as under current law) nor the secondary residence of the property owner. It also directed FEMA to establish standards for a residential property to qualify as a secondary residence eligible for subsidized risk flood insurance premium rates that require the owner to occupy the property for an appropriate minimum period of time each year, and limit subsidized risk premium rates to but a single property of the owner. H.R. 4313 sought to repeal the prohibition against estimating subsidized risk premium rates for business property (thus qualifying business property for such rates) and directed FEMA to refund directly to insureds any flood insurance premiums collected in excess of the rates required under this Act. This legislation was not enacted.
May 2014:	
H.R.4558 and S.2381, by Rep. Dennis Ross (R-FL) and Rep. Patrick Murphy (D-FL) and Sen. Dean Heller (R-NV) and Sen. Jon Tester (D-MT).	H.R.4558 and S. 2381, the Flood Insurance Market Parity and Modernization Act, introduced in May 2014, would ensure that surplus lines insurers are eligible to offer private market solutions and alternatives to consumers needing coverage of unique and complex flood risks. This legislation was not enacted but has been filed again in 2015.
June 2015:	
H.R 2901/S. 1679, by Rep. Dennis Ross (R-FL), Rep. Patrick Murphy (D-FL) and Sen. Dean Heller (R-NV) and Sen. Jon Tester (D-MT)	H.R.2901/S. 1679, the Flood Insurance Market Parity and Modernization Act will provide clarity to lenders that they may accept private flood insurance solutions from the surplus lines market, just as they had prior to the Biggert-Waters Act of 2012.

2014/2015 State Level Legislation/Regulation

State Legislation	The following are bills proposed or enacted at the state level regarding surplus lines:
Kansas	HB 2352 (formerly SB 155) has been signed by the Governor on June 5, 2015. This critical legislation eliminates the requirement to tax multistate risks at other states' rates. Effective January 1, 2016, all surplus lines premium where Kansas is the home state of the insured shall be taxed 100% at Kansas's rate of 6%. Kansas was one of seven states that continued to tax multistate risks at multiple states' rates, although they retained 100% of the tax. Kansas now joins the majority of states that have fully implemented the home state tax approach as envisioned under the NRRA. The legislation also rescinded Kansas's participation in the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT). Having failed to reach the required ten member states, SLIMPACT never became operational.

Louisiana	HB 259, passed by the Louisiana legislature on June 12, 2015 and signed into law by the governor on July 1, 2015, removes the requirement for the state to participate in the Nonadmitted Insurance Multistate Agreement (NIMA), allowing the Commissioner to withdraw effective October 1. The new law will also reduce the surplus lines premium tax from 5% to 4.85% and, when Louisiana is the home state, taxes 100% of the premium regardless of where the risk is located. Additionally, the law revises the required "zero premium" report from a quarterly to an annual filing.
North Dakota	HB 1146, signed by the Governor on March 20, 2015, eliminates the requirement to tax multistate risks at other states' rates. Effective June 1, 2015, all surplus lines premium where North Dakota is the home state of the insured shall be taxed 100% at North Dakota's rate of 1.75%. North Dakota was one of seven states that continued to tax multistate risks at multiple states' rates, although they retained 100% of the tax. North Dakota now joins the majority of states that have fully implemented the home state tax approach as envisioned under the NRRA. The legislation also rescinded North Dakota's participation in the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT). Having failed to reach the required ten member states, SLIMPACT never became operational. SB 2187, signed by the Governor on March 26, 2015, standardized the date for tax filings and payments. Prior law required taxes to be filed before May 1 and annual tax statements to be filed on or before April 1. Effective June 1, 2015, both taxes and the annual tax statement will be filed by March 1.
Utah	SB 212 was enacted on March 26, 2015 and repeals HB 129, which passed in March 2014, and required surplus lines insurers to initiate an audit within six months of expiration of the policy and prohibited surplus lines insurers from counting as earned premium an amount in excess of 50% of the initial premium.
State Reporting Changes	**The following states issued bulletins or legislative changes regarding surplus lines taxes:**
Arizona	HB 2342 was passed to clarify the role and voting procedures of the Surplus Line Association. It originally included language to clarify that for group insurance contracts, the home state is the state of incorporation or organization of the group, however, this provision was removed before passage.
California	SB 585 will require insurers, including nonadmitted, to notify the Department of Child Support Services if a claim is owed to any person owing a duty of child, spouse of family support. The Department of Insurance is charged with creating a system and regulatory guidance for use by insurers. The legislation is currently awaiting hearing in the Assembly Insurance Committee.
Colorado	Bulletin No. B-2.10: This bulletin was issued to clarify standards for taxation based upon changes that were made to the Colorado statute in 2012 to implement the NRRA.
Connecticut	HB 6865 was passed on June 2, 2015 and required nonadmitted insurance policies to include the definition of depreciation per C.S.A §38a-307 when a coinsurance clause is issued. The surplus lines industry opposed the legislation with significant concerns that it imposed form requirements on nonadmitted policies as well as limiting application to the nonadmitted market. The legislation narrowly passed both chambers and a number of industry members requested the Governor veto the measure, which he did on June 30. HB 6771 permits nonadmitted insurers to establish an office in Connecticut for the lawful transaction of surplus lines insurance. The legislation takes effect October 1, 2015.
Delaware	HB 40 was signed by the Governor on June 4, 2015 to remove the notarization requirement for diligent search broker affidavits. The documents are now considered written statements to be retained in the broker's files.
Florida	HB 252 provided that the absence of a countersignature on a policy does not affect the validity of a surplus lines policy and became effective July 1, 2015. SB 1094 revised the existing statute to specifically require agents placing coverage outside of the National Flood Insurance Program (NFIP), including surplus lines polices, to obtain acknowledgement from the applicant that if the applicant discontinues coverage under the NFIP that is provided at a subsidized rate, the full risk rate for flood insurance may apply to the property if the applicant later seeks to reinstate coverage under the program. The legislation also became effective July 1, 2015. It should be noted that the underlying statute allows a surplus lines agent to export flood coverage to an eligible surplus lines insurer without making a diligent effort. This exemption is set to expire on July 1, 2017.
Illinois	SB 1573 would repeal provisions of 2014's SB 3324, which deleted language for the industrial insured exemption; however, the bill is still pending and it is considered unlikely to pass. The Department of Insurance issued a bulletin regarding the definition of industrial insured on June 18, 2015.

State	Activity
Kansas	SB 145 was the only legislative activity regarding insurer eligibility during this legislative session, but failed to be adopted. This bill would have revised the definition of eligible insurer to conform to the definition and intention of the NRRA and would have removed the requirement of appearing on an eligibility list, but would have allowed the commissioner to maintain a voluntary list. The Department has indicated it is willing to discuss the industry's concern with the current eligibility listing requirements in the near term.
Louisiana	Bulletin 2015-06: On July 15, 2015 the Department of Insurance issued Bulletin 2015-06, also effective October 1, 2015, to provide guidance to the industry on how to report and file taxes under the both prior to and after the state withdraws from NIMA and the revised tax mechanism becomes effective. HB 214 creates a domestic surplus lines insurer (DSLI). This law becomes effective on August 1, 2015.
Maryland	Bulletin 15-12: A request for Maryland surplus lines brokers to provide the data regarding claims relating to the Baltimore City Civil Unrest pursuant to Maryland Insurance Code §§2-206(1) and 3-322. Data shall be submitted for each surplus lines company the surplus lines broker represents, by line of business, for the City of Baltimore using the link to the Severe Event Data Collector. SB 868 was signed by the Governor on May 12. This legislation addressed requirements for Transportation Network Companies (TNC) operating in the state. The legislation originally proposed specific rate and form approval for surplus lines insurers, which industry members strongly opposed. Work with the Department of Insurance and legislature successfully resulted in alternative language so that surplus lines insurers are not required to file TNC policies with the Department; rather, the Public Utilities Commission may request a copy of the policy for review prior to approving the TNC's license to operate in the state. HB 565 is enacted legislation that authorizes the use of surplus lines insurance for disability insurance coverage under specified circumstances and provides that the procurement of specified disability insurance through surplus lines insurance is subject to specified requirements. The law will take effect October 1, 2015.
Massachusetts	SB 479 would establish hybrid personal injury protection policies as an option to fulfill required coverage in Massachusetts. The bill contemplates that nonadmitted insurers may also file such a form. The legislation is still pending.
Michigan	HB 4532 was filed on April 28, 2015 in Michigan to revise some statutes related to NRRA. The legislation remains pending.
Minnesota	HB 177 takes effect on August 1, 2015 and will regulate self-service storage facilities and require them to obtain insurance that may be obtained through a surplus lines company. In May, the Minnesota Joint Underwriting Association attempted to assess surplus lines companies as part of their guaranty assessment but issued a stay after discussions with surplus lines industry trade associations.
Mississippi	SB 2254 exempts from premium taxes the surplus lines policies procured by the Mississippi Department of Administration. The bill became effective July 1, 2015.
Montana	HB 94 was enacted on February 24th to allow natural disaster multi-peril insurance to be sold as surplus lines insurance; HB 240 was enacted on April 10th to remove prohibition of surplus lines policy fees, but limits the fee to $50 for personal lines and $100 for commercial lines.
New Jersey	The New Jersey Department responded to comments that interested parties submitted last August on changes to Regulation 11:19-3.1 through 3.5 that were adopted April 21. The Regulation became effective May 18 and pertains to requirements of the new electronic filing system for surplus lines transactions. The Department declined to make many changes based on the comments they received and the final regulation remains similar to the original proposal.
New York	Insurance Reg. 41 (11 NYCRR Part 27): Titled the Proposed 14th Amendment to Insurance Regulation 41, this amendment applies to the excess line placements governing standards to conform to the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA). On October 8, 2014, the New York Department of Financial Services (DFS) adopted their proposed amendments to Regulation 41. This regulation details the state's standards governing surplus lines placement in New York. The amendments incorporate changes in the standards related to the NRRA. AB 9590 was signed by the Governor on January 29, 2015 and prevents third parties from demanding the issuance of a Certificate of Insurance (COI) that goes beyond simply demonstrating proof that insurance coverage has been placed. AB 4616 was signed by the Governor on March 13 and requires Certificates of Insurance on policies for Personal Injury Liability or Property Damage Liability to be issued on a form promulgated by the insurer or a form approved by the Department.

Nevada	AB 486 removes statutory fees for surplus lines companies ($1,300 annually) and removes mandatory $15 Insurance Recovery Account fee for surplus lines brokers and replaces it with an assessment of $10 to be imposed by the Commissioner only after the Insurance Recovery Account falls below $40,000. The bill became effective July 1, 2015.
North Carolina	HB 262 authorized the creation of the North Carolina Stamping Office, making it the 15th stamping office in the nation. The legislation is expected to take effect within 60 days of adjournment, which is projected to be around July 26, 2015.
Oklahoma	SB 487 became effective April 10 and removes diligent search effort requirements in the procurement of flood insurance through surplus lines insurers.
Oregon	SB 935 became effective on June 18 and exempts wet marine and transportation insurance from the requirement to obtain certificate of authority. The Division adopted O.A.R. 836-010-0026 in March which prohibits the use of discretionary clause language in insurance contracts for all lines of insurance.
Pennsylvania	SB 736, if passed, will regulate self-service storage facilities and will allow the required insurance to be obtained through a surplus lines insurer.
South Dakota	HB 1088 became effective February 24th and amends prior law to allow surplus lines insurers to provide excess disability insurance.
Tennessee	SB 82 becomes effective January 1, 2016 and requires broker affidavits to be filed within 30 days of issuing a policy. Prior to enactment of the law, affidavits were to be issued at the end of each month. Additionally, effective February 16, the Department began using OPTins for electronic payments for surplus lines premium tax
Texas	HB 409 would have required liquor licensees to carry liquor liability insurance. This type of insurance is not currently required. The bill would have allowed the coverage to be provided from an admitted or eligible surplus lines insurer but failed to pass out of the House. HB 686 related to insurance agents' ownership and use of information related to the expiration of property and casualty insurance policies. The proposed bill would have allowed an agent the exclusive ownership and use of an "expiration" directly related to an insurance application submitted by or an insurance policy written through that agent for the purpose of soliciting, selling or negotiating the renewal or sale of the coverage. The bill failed to pass out of committee. HB 2947 was sought to revise diligent search requirements. The bill was proposed as a compromise based on indications from the Department on their intent to revise regulations regarding the requirements. Ultimately the Department decided not to change the current procedure and the legislation was allowed to die.
Virginia	HB 1745 became effective July 1, 2015, and increases the maximum assessment of fire insurance companies, including surplus lines policies, for the Fire Programs Fund from .01 to .025%.
Washington	HB 1308 clarified that the portion of a risk located outside of the U.S. is exempt from surplus lines premium tax. The law has been signed by the Governor and became effective July 24, 2015.
Wisconsin	OCI Bulletin 05-14: This bulletin informs surplus lines insurers of changes to filing requirements, effective July 1, 2014. This is the result of the Wisconsin Office of the Commissioner of Insurance (OCI) declining to join the Nonadmitted Insurance Multi-State Agreement, Inc. (NIMA) as a full member.

Sources: Library of Congress, National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) and individual states' legislative websites.

Update on the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA)

The NRRA was passed as a provision of the Dodd-Frank Wall Street Reform Act of 2010 (DFA). Some leaders, and other members of the 114th U.S. Congress, have stated that revisions and repeals of provisions of the DFA are a high priority, but the NRRA has not been identified as a specific target in these discussions.

Similar to what was reported in the 2014 segment review, as of 2015, all states except Michigan, as well as the District of Columbia, have adopted specific NRRA implementation language. Both of those jurisdictions, however, follow the NRRA in practice and continue to comply with the NRRA's home state tax approach. The NRRA, which was passed by Congress in July 2010 and took effect one year later, resulted in the following reforms related to surplus lines/nonadmitted insurance:

- Limited the regulation and taxation of surplus lines/nonadmitted transactions to only one state - the home state of the insured, meaning the state where a commercial insured's principal place of business is located, or if the insured is an individual, the individual's state of residence.

- Established uniform, nationwide eligibility standards based on two sections of the National Association of insurance Commissioners' Nonadmitted Model Act for U.S.-domiciled nonadmitted insurers. The model act defines an eligible surplus line insurer as being authorized in its state of domicile to write the coverage being offered on a nonadmitted basis and meeting specified capital and surplus standards. The NRRA also requires states to allow licensed surplus lines brokers to place or procure insurance from any alien (non-U.S.-based nonadmitted insurer) that is on the NAIC Quarterly Listing of Alien Insurers.

- Created a nationwide definition of an exempt commercial purchaser (ECP), applicable in each state, for which a broker can access the surplus lines market without the need of a diligent search being performed.

The simplification of the regulation and taxation of the surplus lines insurance transaction is the key focus, and many feel, the greatest success of the NRRA. The law called on each state to adopt nationwide, uniform requirements, forms and procedures for the reporting, payment, collection and allocation of surplus lines premium taxes and recognized that states may form compacts or other mechanisms to share surplus lines premium taxes paid to an insurer's home state. The home state provision has produced significant benefits for the surplus lines industry by reducing the need for brokers and insurers to comply with differing sets of rules, disclosures and requirements. Effective October 1, 2015, 47 jurisdictions[1], representing 86% of the nationwide surplus lines premium, will retain 100% of the taxes they collect, and effective January 1, 2016, 41 of those jurisdictions will tax 100% of any multistate risk in accordance with the home state's tax rates and rules.

Also effective October 1, 2015, Louisiana will withdraw from the Non-Admitted Insurance Multi-State Agreement (NIMA). In addition to retaining 100% of the taxes collected at their own premium tax rate, they will now also tax 100% of the surplus lines risk, regardless of where it resides. HB 259 was passed during the 2015 legislative session to effectuate these changes. In addition to the above-noted changes, the surplus lines premium tax rate will decrease from 5% to 4.85%.

Only five jurisdictions - Florida, Puerto Rico, South Dakota, Utah and Wyoming - remain in NIMA and continue to share taxes as part of their membership. Tennessee currently participates as an associate member of NIMA and, as a result, requires surplus lines brokers

[1] AK, AL, AR, AZ, CA, CO, CT, DC, DE, GA, HI, IA, ID, IL, IN, KS, KY, LA, MA, MD, ME, MI, MN, MO, MS, MT, NC, ND, NE, NH, NJ, NM, NV, NY, OH, OK, OR, PA, RI, SC, TN, TX, VA, VT, WA, WI, WV

to provide multistate allocation information to NIMA's Surplus Lines Clearinghouse (SLC). Tennessee's associate membership expires on October 1, 2015, and the state will need to decide if it wishes to join NIMA as a full member. Wisconsin participated in the one-year associate membership but on June 25, 2015, declined to join as a full member.

There are five non-NIMA jurisdictions that continue to tax multistate risks at multiple jurisdictions' rates, although they retain 100% of the tax. These jurisdictions include Hawaii, Massachusetts, Nebraska, New Hampshire and Vermont. Prior to the 2015 legislative session, Kansas and North Dakota also required brokers to collect surplus lines premium taxes based on an allocation of risk and at other jurisdictions' rates; however, as of June 1, 2015, North Dakota eliminated this requirement and implemented the 100% home state approach such that when North Dakota is the home state, taxes are calculated and remitted based on its 1.75% tax rate. Kansas passed similar legislation but it does not become effective until January 1, 2016 so brokers must continue, until that time, to calculate the tax based on the premium tax rate where the risk resides.

Along with NIMA, the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT) was the other tax-sharing model put forth by various jurisdictions in response to the NRRA. Nine jurisdictions initially adopted SLIMPACT; however, it failed to become operational as it never secured the required tenth member. Three states have withdrawn from SLIMPACT, including Kansas, North Dakota and Tennessee, leaving only six states in the non-operation agreement (Alabama, Indiana, Kentucky, New Mexico, Rhode Island and Vermont). No SLIMPACT states are pushing to make the compact operational and it is believed more states will eventually eliminate the law from their statutes and simply continue to follow the home state approach they already use.

The NRRA also addressed insurer eligibility and provided clear criteria for determining an insurer's eligibility to provide surplus lines insurance in each state. While some states have eliminated many pre-NRRA eligibility requirements such as "white lists," a number of states continue to impose eligibility requirements beyond those outlined in the NRRA. Since the 2014 report, no states have taken legislative or regulatory action to eliminate these additional requirements.

The NAIC's International Insurers Department Quarterly Listing of Alien Insurers has become the accepted regulatory source for establishing eligibility for alien (non-U.S.) insurers that appear on the list as required by the NRRA. The list is maintained by the National Association of Insurance Commissioners (NAIC), and provides brokers, exempt commercial purchasers, and insureds with assurance concerning the eligibility of non-U.S. insurers being utilized to quote or place excess and surplus lines insurance business.

On January 1, 2015, the criteria used to qualify as an ECP were required by the NRRA to be adjusted based on the Consumer Price Index (CPI). The NAIC subsequently recommended to states that the ECP criteria be adjusted as follows:

Criteria	**Pre-2015**	**Post-2015**
Net Worth	USD 20,000,000	USD 22,040,000
Annual Revenues	USD 50,000,000	USD 55,100,000
Annual Budgeted Expenditures	USD 30,000,000	USD 33,060,000

It was not the intent of the NRRA to have any effect on prices or the availability of coverage. Based on the information in the 2014 Government Accountability Office report on the effects of the NRRA, market participants have stated that the NRRA has indeed had little, if any, effect

on the prices or availability of coverage. According to the surplus lines insurers contacted by the GAO, the NRRA has caused little noticeable shifting in coverage between the admitted and surplus lines markets, which, again, was not the intent of the legislation.

Federal Flood Insurance Legislation

In June of 2015, lawmakers introduced a bipartisan measure, the Flood Insurance Market Parity and Modernization Act, designed to clarify provisions of the National Flood Insurance Program (NFIP) to ensure private market flood insurance solutions are accepted by lenders. The law would clarify that lenders may accept coverage either alternatively or in addition to that made available through the NFIP in order to meet the mandatory purchase requirements of the National Flood Insurance Act in 42 U.S.C.A §4012a. This legislation is important to surplus lines insurers in order to preserve the coverages they historically provided, as well as to modernize the definition of private flood insurance to reflect the "eligible insurer" and "home state" terminology adopted in federal law through the NRRA.

The bipartisan bill was introduced by Representatives Dennis Ross (R-FL) and Patrick Murphy (D-FL) and Senators Jon Tester (D-MT) and Dean Heller (R-NV). A similar bill was introduced last year, but failed to pass.

Section IV – Current Distribution Trends

Surplus lines coverage solutions emerge when the standard market cannot provide needed coverages. As new exposures arise, the surplus lines market often provides the best, or sometimes the only, solution for retail producers and insureds seeking coverage for these exposures. It was only a few years ago that drones, 3-D printers, and cyber risks were not on anyone's radar screen. In 2015, they are at the forefront of people's minds, including surplus lines professionals. Sharing technologies, such as Uber, and driverless cars can be added to the list of newly emerging risks as well.

Opportunities

With new technologies come new risks, which present an opportunity to provide coverage for those who are looking to protect themselves against these risks. The planned usage of small unmanned aerial vehicles or drones is an example of technology presenting new and unique risks. Drones are being used for property inspections and inspections by insurance claim adjusters, imaging and surveillance applications in law enforcement, search and rescue attempts, and catastrophe response efforts, often obtaining detailed photographs of terrain, homes and people. Risks posed by the use of commercial drones include population safety, property damage, and both security and privacy concerns. It is still to be determined whether the benefits of increased commercial usage of drones are worth the associated risks. Another obvious problem is the already crowded U.S. airspace. From an insurance perspective, surplus lines companies may contribute positively to the resolution of issues related to drones by evaluating the risks and offering solutions to those looking to implement drone technology.

The dawn of 3-D printing is another area that presents opportunities, as well as potential pitfalls. For example, prosthetics can be developed using this technology, and can do wonders for so many people but there also is the risk that they will not work as intended. Who should bear that risk and how should coverage be implemented? In the case of using this technology to develop weapons, specifically non-metallic weapons, there are risks associated with the ability to get non-metallic weapons past metal detectors, creating considerable safety concerns. How such risks are protected against and who bears that risk are issues and questions that still require deep consideration and possibly a few lawsuits to provide clarity.

Cyber threats are a growing loss exposure as well. With mobile devices, information is now at our fingertips 24/7. This may include personal information, medical data, store purchases, bank account information and other confidential material, all of which are enticing targets for cyber criminals. There have been numerous reports of personal data being compromised and this drives up the cost of doing business. Many companies that have previously chosen not to purchase cyber risk insurance are now weighing its importance. Through 2014, approximately 20% of large enterprises carried cyber risk coverage, with an even lower adoption rate among medium- and small-sized enterprises. Cybersecurity threats show no signs of abating; if anything, the opposite is true. Protection against cyber threats is likely to be an increased area of focus, resulting in a significant opportunity that, in terms of insurance, could only be met by surplus lines insurers given the rapidly changing nature and scope of cyber exposures and the state form filing process that admitted insurers are encumbered with. Surplus lines insurers can meet the needs of insureds where standard coverage is insufficient or nonexistent.

Challenges

Competition, consolidation, and pricing are among the primary concerns of producers in the surplus lines space. Surplus lines intermediaries find that some producers are placing

traditionally surplus lines risks in the admitted market. Not surprisingly, current market pricing generally is considered soft to weak due to overcapacity.

NARAB II

The National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II) was signed into law by President Obama in January 2015 as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. While it will take a number of years for this to be implemented, the market view is that NARAB II will make it easier for agents and brokers to conduct business and make the licensing process more streamlined. Productivity is expected to improve and the cost of business and compliance to decrease. NARAB II also aims to make it easier for insurers doing business in multiple states.

Business Trends

It's a mixed bag as far as whether surplus lines business is growing or not. Some companies are experiencing slight, more deliberate growth. Other entities report opportunities for across-the-board growth through varied lines of business. Some surplus lines insurers report feeling squeezed as standard lines insurers write more business that was formerly written mainly in the surplus lines market. Still others see flat growth prospects over the near-term that they expect will remain as such, absent a major catastrophe.

Consolidation

The general feeling is that consolidation has only had a limited impact among surplus lines producers, but there is a bigger concern that consolidation will adversely impact existing relationships and response time. There also is concern that fewer alternatives will be available and that quality will give way to price in the decision-making process.

Technology

A major benefit of effective technology is that when well-implemented, it makes it easier for producers to focus on their main goals. Technology also allows for greater mining of data. Ideally, small businesses benefit from new technology by simplifying tasks while larger companies benefit from greater efficiency. It is very important for future success of surplus lines insurers that as technology changes, they are able to keep pace. Insureds will undoubtedly be using even more advanced technologies in the years ahead. Current employees also may need to be trained to use the tools newly available. Depending on the priorities of the insurer, there may be a significant learning curve involved in becoming an expert at using new tools and technologies effectively.

Investment in New Products

The development of new products and programs remains important to surplus lines insurers. One of the hallmarks of the surplus lines insurance market is the development of new insurance solutions to address new or emerging risks, or to provide improved coverage for known risks. New products and programs continue being developed and launched. Some insurers, however, value the importance of investing in one's core products and expanding into other areas in deliberate, circumspect fashion, as opportunities arise.

Section V – Impairment Trends

Following a drop in 2013 to the lowest levels since 2007, financial impairments in the U.S. admitted property/casualty (P/C) industry dropped a little further in 2014, falling to almost one-third of the 2012 impairment count. Year-over-year, the impairment count was down 20% in 2014 and 44% in 2013.

For the 11th consecutive year, the surplus lines industry recorded no financial impairments for the year.

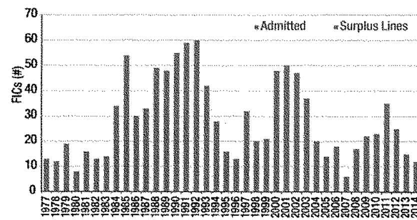
P/C Industry Impairment Experience

The 12 known impairments in 2014 (see **Exhibit 19**), and 15 in 2013, compared with the 25 in 2012, have been more in line with figures seen consistently during the 1970's. A.M. Best assigned ratings to four and reported on seven of the 12 impairments in 2014. Of the companies that were rated, none carried a Secure rating in the year of impairment.

It is possible that additional financial impairments for 2014 and prior years could emerge. There could be a lag in the reporting of impairments due to the increasing use of confidential actions by insurance regulators, who are reluctant to publicly disclose impairments until all possible avenues to rehabilitate or find a buyer for troubled insurers have been exhausted. A.M. Best has found that there is an average 1.5-year lag between a confidential regulatory action and public disclosure of the impairment, usually the time between supervision and liquidation - if the confidential action ever becomes public at all.

Exhibit 19

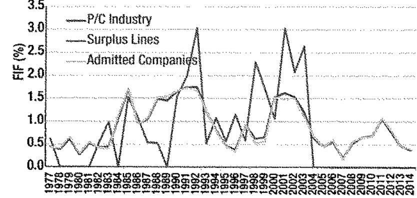
U.S. Property/Casualty – Annual Impairment Count, Admitted Companies vs. Surplus Lines



Source: A.M. Best data and research.

Exhibit 20

U.S. Property/Casualty – Financial Impairment Frequency, Admitted vs. Surplus Lines



Source: A.M. Best data and research, BestLink Best's Statement File – P/C, U.S.

The financial impairment frequency (FIF) is calculated using the number of companies that become impaired in a given year, divided by the number of companies operating in the insurance market in that year. A.M. Best believes the FIF is a more accurate indicator of impairment trends than a simple count. The P/C industry's 2014 FIF was 0.39, below the industry's historical average of 0.91. Reviewing the most recent ten-year-term, the 2011 FIF of 1.06 seems to have marked the peak for impairment frequency, after the 2007-2010 soft-market trough and the 2007-2009 recession.

A.M. Best has found that, historically, increases in the insurance industry's FIF correlate strongly with preceding negative operating environments marked by events such as stock market booms and busts; economic recessions; and extraordinary catastrophe losses that typically force the end of soft markets (see **Exhibits 20 and 21**). Evidence of these trends resides in the increased FIF rates during the periods 1988 to 1993 and 2000 to 2003.

Surplus Lines Impairment Experience

Despite the absence of surplus lines financial impairments from 2004-2014, the industry's failure frequency rate of 0.86% from 1977 to 2014 remains close to the admitted company average of 0.91%. This reflects the surplus

Exhibit 21

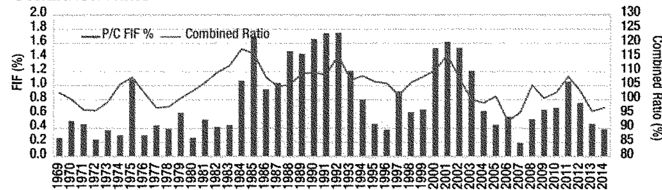
U.S. Property/Casualty – Financially Impaired Companies Count & Frequency Industry vs. Surplus Lines.

	Financially Impaired Companies (FIC)			Financial Impairment Frequency (FIF)[2]		
Year	P/C Industry	Surplus Lines	Admitted Cos.[1]	P/C Industry	Surplus Lines	Admitted Cos.[1]
1977	13	1	12	0.44	0.62	0.43
1978	12	0	12	0.39	0.00	0.41
1979	19	0	19	0.62	0.00	0.66
1980	8	0	8	0.27	0.00	0.28
1981	16	0	16	0.49	0.00	0.55
1982	13	1	12	0.42	0.52	0.41
1983	14	2	12	0.44	0.98	0.40
1984	34	0	34	1.13	0.00	1.14
1985	54	3	51	1.54	1.52	1.54
1986	30	2	28	0.95	1.08	0.94
1987	33	1	32	1.04	0.54	1.07
1988	49	1	48	1.49	0.53	1.55
1989	48	0[3]	48	1.45	0.00	1.54
1990	55	3	52	1.66	1.54	1.67
1991	59	4	55	1.77	1.99	1.76
1992	60	6	54	1.72	3.03	1.64
1993	42	1	41	1.21	0.52	1.25
1994	28	2	26	0.80	1.08	0.79
1995	16	1	15	0.46	0.56	0.45
1996	13	2	11	0.38	1.15	0.34
1997	32	1	31	0.92	0.58	0.94
1998	20	4	16	0.62	2.29	0.53
1999	21	3	18	0.66	1.70	0.60
2000	48	2	46	1.53	1.05	1.56
2001	50	6	44	1.62	3.03	1.52
2002	47	4	43	1.54	2.07	1.50
2003	37	5	32	1.21	2.64	1.11
2004	20	0	20	0.64	0.00	0.68
2005	14	0	14	0.45	0.00	0.47
2006	18	0	18	0.56	0.00	0.60
2007	6	0	6	0.19	0.00	0.20
2008	17	0	17	0.53	0.00	0.56
2009	22	0	22	0.66	0.00	0.69
2010	23	0	23	0.68	0.00	0.71
2011	35	0	35	1.06	0.00	1.11
2012	25	0	25	0.76	0.00	0.81
2013	15	0	15	0.46	0.00	0.49
2014	12	0	12	0.39	0.00	0.40
1977-2014	**1078**	**55**	**1023**	**0.88**	**0.79**	**0.88**

1 Includes alternative markets.
2 Failure frequencies are annualized rates.
3 1989 figures have been adjusted from previous reports to exclude 7 U.K.-domiciled companies.
Source: A.M. Best data and research

lines industry's significantly higher impairment frequencies during certain periods, in particular, 1992, 1998, 1999 and 2001-2003. (See **Exhibit 21.**) Since 2003, with each year that the surplus lines industry has experienced no financial impairments, the historical impairment frequencies for admitted and surplus lines companies have been steadily converging. The failure frequency rate is calculated using the number of companies that become insolvent in a given year, divided by the numberof companies operating in the insurance market in that year.

Exhibit 22
U.S. Property/Casualty – Financial Impairment Frequency vs. Industry Combined Ratio*



*Combined ratios are after policyholders' dividends. A combined ratio below 100 indicates an underwriting profit; above 100, an underwriting loss.
Source: A.M. Best data and research

The primary reason for the absence of surplus lines insurer failures in the mid-2000's related primarily to the surplus lines industry's improved underwriting performance, driven by demonstrated underwriting discipline and adequate pricing, overall. Investments in advanced technologies and improved systems, along with better management reporting and more robust oversight have also helped the impairments to trend positively for surplus lines insurers.

Beginning in 2007, however, underwriting profitability and operating performance began a period of deterioration that lasted through 2012, as indicated by a rise in the surplus lines industry's combined ratio (see **Exhibit 23**), before improvements were recorded in 2013 and again in 2014. For that reason, the absence of impairments in the late 2000's and early 2010's was initially more related to the overall capitalization of surplus lines companies than to underwriting performance. The improvement in profitability in the most recent years should also contribute to the likelihood that the recent impairment trend for surplus lines companies remains favorable.

A.M. Best remains optimistic, but guardedly so, about the low trend of surplus lines impairments with the offsetting factors specifically related to sluggish or, in some cases, weak economic conditions that have prolonged the soft market and contributed to pressure on combined ratios. The persistent low interest rate environment limits the ability of surplus lines (and admitted) companies to potentially withstand or offset any deficiencies in pricing or inadequate risk selection with investment returns and capital market gains.

Causes and Characteristics of Financial Impairments

The causes and characteristics of financial impairments have generally remained consistent for both the surplus lines and admitted P/C industries during the period that A.M. Best has examined impairment data, most recently updated in the special report, *U.S. Property/Casualty - Impairment Review* (August 2015).

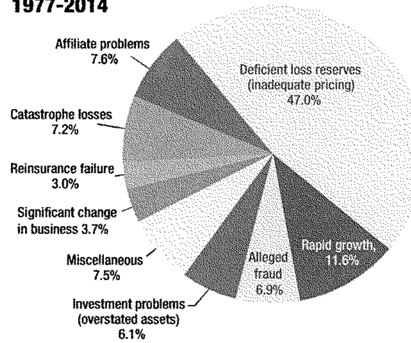
Deficient loss reserves/inadequate pricing and rapid growth have accounted for the largest portion of total impairment among surplus lines and admitted companies. (See **Exhibits 24 and 25.**) These two categories in combination

Exhibit 23
U.S. DPSL* Composite – Financial Impairment Frequency & Combined Ratio

Year	FIF	Combined Ratio
1997	0.58	93.8
1998	1.72	98.5
1999	1.70	99.8
2000	1.05	105.0
2001	3.54	105.3
2002	2.07	93.0
2003	2.64	92.2
2004	0.00	93.5
2005	0.00	93.2
2006	0.00	79.4
2007	0.00	76.1
2008	0.00	93.6
2009	0.00	93.1
2010	0.00	100.5
2011	0.00	105.1
2012	0.00	110.5
2013	0.00	92.4
2014	0.00	88.8

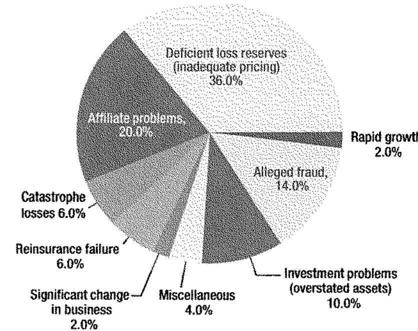
*Domestic Professional Surplus Lines
Source: A.M. Best data and research

Exhibit 24
U.S. Property/Casualty Admitted – Primary Causes of Financial Impairment, 1977-2014



Note: Exhibit % based on companies where the cause of impairment was identified.
Source: A.M. Best data and research

Exhibit 25
U.S. Surplus Lines – Primary Causes of Financial Impairment, 1977-2014



Note: Exhibit % based on companies where the cause of impairment was identified.
Source: A.M. Best data and research

accounted for 38.0% of surplus lines impairments and 58.6% of admitted P/C company impairments.

The second-highest cause of surplus lines impairments has been affiliate problems at 20%, vs. 7.6% for admitted P/C companies. Some surplus lines companies became impaired when their parent companies, which were engaged primarily in the admitted market, were declared insolvent. Some of these past instances of surplus lines failures highlight the extent to which poorly managed operations of a parent company can impact its surplus lines affiliates.

Alleged fraud was the next highest cause of impairment among surplus lines companies at 14.0% vs. 6.9% for admitted companies. All other causes of impairment for surplus lines and admitted insurers accounted for 28% and 26.9%, respectively, of the identified impediments. A.M. Best believes that except for those insolvencies directly related to catastrophe losses, all insolvencies are related to some form of mismanagement. In many instances, companies that become impaired because of catastrophe losses tend to be those concentrated in a particular line of business or geographic area, and have been financially weakened by years of operating losses.

Looking at impairments by line of business, the "other liability" category - encompassing directors and officers (D&O), errors and omissions (E&O), general liability, contractual liability, and excess umbrella - accounted for the highest percentage of surplus lines impairments over the course of time that A.M. Best has studied P/C impairment trends. The workers' compensation and commercial automobile lines caused the second and third highest number of impairments, respectively. Workers' compensation is not a major line of coverage for surplus lines insurers but a surplus lines insurer's impairment could result

from adverse workers' compensation experience of one or more admitted insurers within the same group of companies.

Conclusion

Over the span of time that A.M. Best has studied financial impairments, a strong correlation has been found between the insurance industry's financial impairment frequency and negative operating environments marked by events such as high catastrophe losses; severe downturns in the stock market; or economic recessions. Most often, the triggers for a marked increase in impairments have been sudden, major events that pushed companies already made vulnerable by negative operating performance or mismanagement beyond the brink, and into financial impairment.

Financially Impaired Companies Defined

A.M. Best designates an insurer as a Financially Impaired Company (FIC) as of the first official regulatory action taken by an insurance department, whereby the insurer's:

- Ability to conduct normal insurance operations is adversely affected;
- Capital and surplus have been deemed inadequate to meet legal requirements; and/or
- General financial condition has triggered regulatory concern.

State actions include supervision, rehabilitation, liquidation, receivership, conservatorship, cease-and-desist orders, suspension, license revocation and certain administrative orders. A.M. Best emphasizes that the FICs in this study might not technically have been declared insolvent.Note that the above definition of an FIC is broader than that of a Best's Rating of "E" (under regulatory supervision), which is assigned only when an insurer is "no longer allowed to conduct normal ongoing insurance operations." Thus, a company may be designated as financially impaired in this study but may not have been assigned an "E" Best's Rating. Further, a Best's Rating of "F" (in liquidation) can reflect aliquidation as part of the impairment process, or it can indicate a voluntary dissolution. Unless they occur under financial duress, voluntary dissolutions are not counted as impairments. Before 1992, a Best's Rating of "NA-10" was used to indicate that a company was under regulatory supervision and/or in liquidation.

Revisions

As a result of ongoing research efforts, A.M. Best's impairment database is updated continually to reflect the incorporation of new data or adjustments to existing data. The most common revision to the data is a company's initial year of impairment. If any change places a company outside of this study's parameters, the company is eliminated from the study.

Confidential Supervisions

In addition to the regulatory actions that are announced publicly, there also are actions that insurance regulators undertake on a confidential basis. When A.M. Best becomes aware of an active confidential regulatory action, the impairment is counted in the aggregate analysis, but is not reported on a company-specific basis to protect confidentiality. While the reporting of confidential actions likely is understated, A.M. Best believes a full accounting of these nonpublic actions would not change materially its impairment analysis.

Section VI – Fundamentals of The Surplus Lines Market

The U.S. surplus lines market (also called the nonadmitted market) functions as a supplemental market for insuring risks that are not acceptable to the standard insurance market (also called the admitted market).

The insurers in the surplus lines market are property/casualty companies that distribute their products to consumers through surplus lines producers. Consumers that are unable to secure insurance coverage from standard (admitted) insurers also have the option of self-insuring or seeking coverage in the alternative risk transfer (ART) market.

The risks insured in the surplus lines market are usually classified as one of the following:

- **Distressed risks** - characterized by unfavorable attributes, such as a history of frequent losses or the potential for catastrophic losses that make them unacceptable to admitted insurers. Examples of distressed risks include a vacant building located in an area that experiences frequent crime losses, a shopping mall with frequent liability claims or a manufacturer of explosives.
- **Unique risks** - so specialized or unusual that admitted insurers are unwilling or unprepared to insure them. An example of a unique risk is a medical device manufacturer that needs product liability coverage while a new product is in clinical trials.
- **High-capacity risks** - requiring high insurance limits that may exceed the capacity of the standard market. An example of a high-capacity risk is a chemical plant that could become legally liable for hundreds of millions of dollars in damages if a toxic chemical were to escape in large quantities.
- **New or emerging risks** - requiring special underwriting expertise and flexibility that the surplus lines market can provide. Examples of new or emerging risks that are in need of property and/or liability coverage include the nonmilitary use of unmanned aircraft systems (drones) and marijuana businesses in states that have legalized the medical or recreational use of marijuana.

The surplus lines market has historically been an innovator of new kinds of insurance coverage designed to meet emerging market needs. Examples of policies that were originated by surplus lines carriers include cyber risk, environmental impairment liability, employment practices liability, directors and officers liability, and excess and umbrella liability. These types of policies can now be obtained in either the standard (admitted) insurance market or the surplus lines market, depending on the characteristics of the particular risk.

The majority of surplus lines business consists of commercial lines insurance, although some personal lines coverage, such as homeowners insurance in catastrophe-prone areas, is also written on a nonadmitted basis..

Surplus lines insurers are referred to as nonadmitted insurers because they are not licensed (admitted) in the state where the insured's principal place of business is located or where the insured resides. This state is known as "the insured's home state" and is the state that is responsible by federal law for oversight and regulation of the surplus lines transaction. Every U.S. jurisdiction has a surplus lines law that permits specially licensed intermediaries (surplus lines brokers/licensees) to "export" risks that cannot be placed in the standard market to eligible surplus lines (nonadmitted) insurers.

Although not a licensed insurer in the "home state of the insured," each surplus lines insurer is licensed in its state or country of domicile and is regulated for solvency by that jurisdiction. This is the same approach used by the state-based insurance regulatory system in the United States to assure the

financial stability of licensed or admitted insurers. As a nonadmitted carrier, a surplus lines insurer is not subject to the rate and form regulations of the insured's home state and is therefore free to use policy forms and rates that are appropriate for the risks it accepts. State regulation of licensed or admitted insurers, in contrast, includes the oversight of insurance policy rates and forms. The purpose of this special regulatory approach to surplus lines insurers is to ensure that the surplus lines market provides an open and flexible marketplace for insureds that are unable to fulfill their insurance requirements in the state's admitted or standard market.

When the insurance market or capacity becomes restricted and market conditions "harden," standard market carriers typically reduce their appetites for some risks or lines of insurance, and business flows into the surplus lines market. Even under normal market conditions or when the market is considered "soft," there are still many distressed, unique, high-capacity and new or emerging risks that require surplus lines treatment. In fulfilling the role of insuring risks that the admitted market cannot or will not insure, the surplus lines market operates as a "safety valve" for the insurance marketplace.

The minimum capitalization requirement for surplus lines insurers is generally higher in each state than it is for admitted insurers. This enhanced capital standard provides greater protection for policyholders insured by surplus lines companies, since state guaranty fund protection, provided to policyholders of admitted insurers that become insolvent, is not generally available to surplus lines insureds. (See Section II for current financial trends in the surplus lines market).

Market Cycles

In general, the condition of the admitted insurance market affects the state of the surplus lines market. (See Section I for the latest surplus lines market trends). This impact, on occasion, can be significant. When admitted market conditions harden or become more difficult, a sizable amount of business flows from the admitted market to the surplus lines market. During a hard market, underwriters tend to become more conservative and restrictive, examining loss exposures more carefully to determine how a particular risk under consideration can be written at a profit.

In these circumstances, standard market carriers only insure those risks that they are most comfortable in assuming and tend to avoid risks that are more complex or with which they have little or no experience.

As the market cycle progresses, competition heats up and market conditions in the admitted market "soften" as producers and insurers strive to maintain market share by reducing rates, expanding coverage and offering additional services at the expense of profit margins. During this soft market phase of the cycle, consumers' bargaining power increases significantly, causing rates to drop and coverage limitations or exclusions to be relaxed. When these circumstances occur, business begins to return to the admitted market.

Over time, competitive pricing pressures erode admitted market capacity as margins deteriorate to unprofitable levels. This again leads to a hardening of the market, and the cycle continues.

Industry Participants

For the purposes of this report, A.M. Best has categorized surplus lines insurers into three broad segments:

- Domestic professional companies: This largest segment is represented by U.S.-domiciled insurers that write 50% or more of their total premium on a nonadmitted basis.
- Domestic specialty companies: U.S.-domiciled insurers that operate to some extent on a nonadmitted basis but whose direct nonadmitted premium writings amount to less than 50% of their total direct premiums written.

- Regulated aliens (including Lloyd's): To qualify as a regulated alien, insurers must file financial statements, copies of auditors' reports, the names of their U.S. attorneys or other representatives and details of their U.S. trust accounts with the International Insurers Department (IID) of the National Association of Insurance Commissioners (NAIC). Additionally, regulated aliens must fulfill criteria established by the IID concerning capital and/or surplus, reputation of financial integrity, and underwriting and claims practices. On a quarterly basis, the NAIC publishes its Quarterly Listing of Alien Insurers, which lists alien insurers that meet its criteria.

As a result of the Nonadmitted and Reinsurance Reform Act (NRRA) of 2010, which was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, a state may not prohibit a surplus lines broker from placing nonadmitted (surplus lines) insurance with or procuring such insurance from a nonadmitted insurer listed on the NAIC Quarterly Listing of Alien Insurers.

Distribution

Retail producers, surplus lines intermediaries and program managers are the primary distributors for surplus lines insurers. All of these entities play an important role in helping consumers find insurance coverage that is unavailable in the standard market. (See Section IV for a description of current surplus lines distribution issues).

For purposes of this special report, the types of organizations within the surplus lines distribution system are defined as follows:

- Retail producers can be either agents that represent the insurer or brokers that represent the insured.
- Surplus lines intermediaries can operate as wholesale brokers, managing general agents (MGAs), underwriting managers or Lloyd's coverholders or open market correspondents (OMCs).
- Program managers are managers of specialty or niche insurance products and market to retailers, wholesalers or both.

Surplus lines intermediaries are licensed in the states where the insured or risk is located and act as intermediaries between retail producers and surplus lines insurers. Typically, a surplus lines intermediary provides the retail producer and the insured with access to the surplus lines market when the admitted market cannot provide coverage or the risk otherwise qualifies for export.

The basic difference between wholesale brokers and MGAs is that MGAs are authorized to underwrite and bind coverage on behalf of the surplus lines insurer through binding authority agreements. Wholesale brokers only have the authority to submit business to surplus lines insurers. The insurers then underwrite, quote and, if the risk is considered to be acceptable, bind the risk. In addition, some MGAs have claims-handling responsibilities and may be involved in the placement of reinsurance.

Lloyd's coverholders are authorized to bind coverage on behalf of underwriting syndicates at Lloyd's. OMCs are approved for placing coverage at Lloyd's either directly or through a Lloyd's broker.

Surplus lines laws generally require that a "diligent search" of the admitted market be performed before a risk can be exported to a surplus lines insurer. In general, the diligent-search requirement, which assures the admitted market the first opportunity to insure the risk, requires that three declinations from admitted insurers be obtained before the risk can be placed in the surplus lines market.

In certain states, specified types of risks can be placed in the surplus lines market without the diligent search requirement being fulfilled. Many states have created an "export list," which sets forth types of risks for which the insurance commissioner has determined there is little or no

coverage available in the state's admitted market. A type of risk that appears on the export list can be exported, without a diligent search, to an eligible surplus lines insurer. Also, a few states have commercial lines deregulation laws that allow for "automatic export" waivers, giving qualifying commercial buyers and their brokers or intermediaries immediate access to the surplus lines market, as well as access to a deregulated admitted market, without a diligent search.

In a surplus lines transaction, the surplus lines intermediary is generally responsible for:

- Filing an affidavit affirming that a diligent search has been performed, when it is required;
- Maintaining the records relating to the transaction; and
- Collecting premium taxes and remitting them to the insured's home state.

In addition to facilitating the surplus lines placement, the surplus lines intermediary provides a number of services, which include:

- Technical expertise about the risk to be insured;
- Extensive insurance product and market knowledge;
- Ability to respond quickly to changing market conditions; and
- Access to eligible surplus lines insurers.

Licensing and Compliance

In a surplus lines transaction, the insured's home state exercises the greatest degree of regulatory oversight, and the onus of regulatory compliance is placed on the surplus lines broker or licensee, which is the regulated entity in the transaction.

In addition to being a licensed (resident or nonresident) agent or broker, a surplus lines broker or licensee must do the following:

- In many states, pass a written surplus lines licensing examination to secure a resident license;
- Collect the state's surplus lines premium taxes;
- Pay an annual licensing fee; and
- Determine whether the risk meets all the requirements for placement with a surplus lines insurer.

Further, the surplus lines broker or licensee is responsible for determining whether the nonadmitted insurer insuring the risk meets the insured's home state eligibility requirements. A broker or licensee may be held liable for payment of claims when a risk is placed with a surplus lines insurer not authorized to receive the risk, or with one that is financially unsound when the risk is bound. However, depending on state law, there may be no cause of action against a broker, under a negligence standard, who exercises due diligence or care in selecting the insurer, even if the insurer becomes insolvent years later.

Surplus lines policies must disclose that a nonadmitted insurer is providing coverage and that guaranty fund protection will not be available if the insurer becomes insolvent.

Conclusion

This section on "Fundamentals" is a primer for readers who are not already familiar with the surplus lines market, to assist them in understanding this unique insurance marketplace and to put the other sections of this report into context. The fundamentals of the surplus lines market include the participants and their roles, the types of risks insured, the regulatory structure and the responsibilities imposed on the surplus lines broker/licensee and the dynamic role of market cycles.

Appendix A

U.S. Surplus Lines - Top 50 Groups, 2014

Ranked by direct premims written
(USD Thousands)

Rank	A.M. Best #	Group Name	Type of Company	Surplus Lines DPW	Year/Year Change in DPW	Total Group PHS	Best's Financial Strength Rating*	Financial Strength Rating Outlook / Implications	Rating Effective Date
1	085202	Lloyds		$8,157,000	14.9%		A	Positive	22-Jul-15
2	018540	American International Group		$4,679,470	-3.2%	$6,616,409			
2	003535	AIG Specialty Insurance Co	PROF	$899,194		$45,363	A	Stable	27-Feb-15
2	002361	Illinois National Insurance Co	MISC	$63		$36,972	A	Stable	27-Feb-15
2	002350	Lexington Insurance Company	PROF	$3,780,213		$6,534,074	A	Stable	27-Feb-15
3	005987	Nationwide Group		$1,780,987	7.1%	$956,234			
3	001931	Scottsdale Indemnity Company	MISC	$23,141		$37,232	A+	Stable	19-Mar-15
3	003292	Scottsdale Insurance Company	PROF	$1,559,064		$764,852	A+	Stable	19-Mar-15
3	012121	Scottsdale Surplus Lines Ins	PROF	$10,828		$46,666	A+	Stable	19-Mar-15
3	000601	Western Heritage Insurance Co	PROF	$187,954		$107,484	A+	Stable	19-Mar-15
4	018252	W. R. Berkley Insurance Group		$1,485,813	11.9%	$996,022			
4	003026	Admiral Insurance Company	PROF	$443,067		$615,642	A+	Stable	22-Jan-15
4	014158	Berkley Assurance Company	PROF	$42,926		$51,746	A+	Stable	22-Jan-15
4	011296	Berkley Regional Specialty Ins	PROF	$22,204		$52,934	A+	Stable	22-Jan-15
4	012118	Gemini Insurance Company	PROF	$467,658		$54,271	A+	Stable	22-Jan-15
4	011231	Great Divide Insurance Co	MISC	$2,975		$66,909	A+	Stable	22-Jan-15
4	001990	Nautilus Insurance Company	PROF	$506,983		$154,521	A+	Stable	22-Jan-15
5	018549	Zurich Financial Svcs NA Group		$1,204,753	-2.2%	$565,903			
5	002147	Empire Fire & Marine Ins Co	MISC	$285		$44,396	A+	Stable	26-Nov-14
5	002148	Empire Indemnity Ins Co	PROF	$151,349		$50,030	A+	Stable	26-Nov-14
5	003557	Steadfast Insurance Company	PROF	$1,051,685		$436,185	A+	Stable	26-Nov-14
5	003565	Zurich American Ins Co of IL	MISC	$1,433		$35,292	A+	Stable	26-Nov-14
6	018468	Markel Corporation Group		$1,191,418	3.8%	$1,319,262			
6	003677	Alterra Excess & Surplus Ins	PROF	$192,957		$158,321	A	Stable	15-May-15
6	004898	Associated International Ins	PROF	$41,394		$109,075	NR		
6	002732	Essex Insurance Company	PROF	$472,335		$416,532	A	Stable	15-May-15
6	003759	Evanston Insurance Company	PROF	$484,732		$635,334	A	Stable	15-May-15
7	018498	ACE INA Group		$1,032,388	5.7%	$329,338			
7	003510	Illinois Union Insurance Co	PROF	$457,250		$159,550	A++ u	Negative	2-Jul-15
7	004433	Westchester Surplus Lines Ins	PROF	$575,138		$169,787	A++ u	Negative	2-Jul-15
8	018728	Ironshore Insurance Group		$894,986	20.1%	$482,419			
8	013847	Ironshore Indemnity Inc.	MISC	$14,286		$156,603	A u	Negative	31-Jul-15
8	013866	Ironshore Specialty Ins Co	PROF	$880,700		$325,815	A u	Negative	31-Jul-15
9	000811	Berkshire Hathaway Ins Group		$835,316	48.0%	$7,649,707			
9	003806	General Star Indemnity Co	PROF	$156,426		$615,985	A++	Stable	17-Jun-14
9	002540	Mount Vernon Fire Ins Co	PROF	$98,329		$395,241	A++	Stable	12-Jun-15
9	002428	National Fire & Marine Ins Co	PROF	$540,747		$5,604,726	A++	Stable	21-May-14
9	001824	National Indem Co of the South	MISC	$1,280		$177,447	A++	Stable	21-May-14
9	004406	National Indem Co of Mid-Amer	MISC	$1,415		$170,269	A++	Stable	21-May-14
9	003736	U S Underwriters Insurance Co	PROF	$28,975		$122,718	A++	Stable	12-Jun-15
9	002541	United States Liability Ins Co	MISC	$8,144		$563,321	A++	Stable	12-Jun-15
10	003116	Fairfax Financial (USA) Group		$793,974	-5.2%	$525,347			
10	012347	American Safety Indemnity Co	PROF	$9,493		$128,147	NR		
10	011123	Crum & Forster Specialty Ins	PROF	$132,197		$47,313	A	Stable	4-Jun-15
10	011883	First Mercury Insurance Co	PROF	$319,461		$55,862	A	Stable	4-Jun-15
10	014995	Hudson Excess Insurance Co	PROF	$13,192		$58,847	A	Stable	5-May-15
10	012631	Hudson Specialty Ins Co	PROF	$209,371		$186,779	A	Stable	5-May-15
10	012258	Seneca Specialty Ins Co	PROF	$110,260		$48,400	A	Stable	4-Jun-15
11	018640	Alleghany Ins Holdings Group		$780,702	2.1%	$373,242			
11	001960	Capitol Specialty Ins Corp	PROF	$82,733		$53,485	A	Stable	24-Apr-15
11	013859	Covington Specialty Ins Co	PROF	$161,540		$48,515	A+	Stable	24-Apr-15
11	022013	Fair American Select Ins Co	PROF	$3,666		$46,887	A	Positive	24-Apr-15
11	012619	Landmark American Ins Co	PROF	$532,764		$224,355	A+	Stable	24-Apr-15
12	018313	CNA Insurance Companies		$745,886	-7.7%	$241,607			
12	003538	Columbia Casualty Company	PROF	$745,886		$241,607	A	Stable	16-Dec-14
13	018130	XL America Group		$726,916	17.2%	$97,731			

Appendix A

U.S. Surplus Lines - Top 50 Groups, 2014

Ranked by direct premims written

(USD Thousands)

Rank	A.M. Best #	Group Name	Type of Company	Surplus Lines DPW	Year/Year Change in DPW	Total Group PHS	Best's Financial Strength Rating*	Financial Strength Rating Outlook / Implications	Rating Effective Date
13	011340	Indian Harbor Insurance Co	PROF	$726,883		$46,171	A	Stable	1-May-15
13	002424	XL Select Insurance Company	PROF	$33		$51,560	A	Stable	1-May-15
14	018603	AXIS Insurance Group		$591,135	8.0%	$205,938			
14	012515	AXIS Surplus Insurance Company	PROF	$591,135		$205,938	A+	Stable	4-Aug-15
15	000012	Chubb Group of Insurance Cos		$574,425	36.1%	$1,599,066			
15	002713	Chubb Custom Insurance Co	PROF	$526,899		$187,382	A++ u	Negative	2-Jul-15
15	003761	Executive Risk Indemnity Inc	MISC	$549		$1,258,019	A++ u	Negative	2-Jul-15
15	011251	Executive Risk Specialty Ins	PROF	$46,976		$153,664	A++ u	Negative	2-Jul-15
16	018484	Arch Insurance Group		$548,931	0.3%	$292,438			
15	012523	Arch Specialty Insurance Co	PROF	$548,931		$292,438	A+	Stable	21-Aug-15
17	004019	Argo Group		$526,338	5.3%	$371,142			
17	003283	Colony Insurance Company	PROF	$522,240		$319,845	A	Stable	2-Oct-14
17	002619	Colony Specialty Insurance Co	MISC	$4,190		$19,989	A	Stable	2-Oct-14
17	011035	Peleus Insurance Company	PROF	-$93		$31,309	A	Stable	2-Oct-14
18	018713	QBE Americas Group		$522,550	-32.7%	$197,459			
18	012562	QBE Specialty Insurance Co	PROF	$522,550		$197,459	A	Stable	15-Jan-15
19	018591	Allied World Assurance Group		$517,559	10.9%	$361,815			
19	012525	Allied World Asr Co (US) Inc	PROF	$213,588		$139,608	A	Stable	16-Dec-14
19	012526	Allied World National Assur Co	MISC	$61,990		$129,657	A	Stable	16-Dec-14
19	011719	Allied World Surplus Lines Ins	PROF	$241,982		$92,550	A	Stable	16-Dec-14
20	004835	Great American P & C Ins Group		$472,564	20.0%	$243,487			
20	003735	American Empire Surplus Lines	PROF	$149,529		$108,414	A+	Stable	20-Mar-15
20	010937	Great Amer Protection Ins Co	PROF	$301		$26,038	A+	Stable	20-Mar-15
20	003837	Great American E&S Ins Co	PROF	$309,094		$45,955	A+	Stable	20-Mar-15
20	003293	Great American Fidelity Ins Co	PROF	$10,832		$45,981	A+	Stable	20-Mar-15
20	014150	Mid-Continent E&S Ins Co	PROF	$2,807		$17,099	A+	Stable	20-Mar-15
21	018720	Catlin US Pool		$443,724	15.3%	$204,276			
21	010092	Catlin Specialty Insurance Co	PROF	$443,724		$204,276	A	Stable	1-May-15
22	018604	State National Group		$434,505	84.4%	$74,980			
22	013105	United Specialty Insurance Co	PROF	$434,505		$74,980	A	Stable	9-Jun-15
23	018783	Aspen US Insurance Group		$425,002	36.6%	$131,940			
23	012630	Aspen Specialty Insurance Co	PROF	$425,002		$131,940	A	Stable	23-Oct-14
24	018756	Starr International Group		$396,987	30.4%	$97,237			
24	013977	Starr Surplus Lines Ins Co	PROF	$396,987		$97,237	A	Stable	20-Oct-14
25	003262	Swiss Reinsurance Group		$378,134	14.7%	$118,685			
25	010783	First Specialty Ins Corp	PROF	$222,710		$70,136	A+	Stable	6-Nov-14
25	011135	North American Capacity Ins Co	PROF	$155,424		$48,550	A+	Stable	6-Nov-14
26	018723	HCC Insurance Group		$375,470	6.3%	$1,908,061			
26	003286	Houston Casualty Company	PROF	$356,178		$1,891,871	A+	Stable	25-Sep-14
26	012531	HCC Specialty Ins Co	PROF	$19,292		$16,190	A+	Stable	25-Sep-14
27	018674	Travelers Group		$360,946	9.1%	$960,742			
27	004869	Northfield Insurance Co	PROF	$115,829		$126,184	A++	Stable	28-May-15
27	004025	Northland Casualty Company	MISC	$984		$35,409	A++	Stable	28-May-15
27	000712	Northland Insurance Company	MISC	$4,159		$538,940	A++	Stable	28-May-15
27	003592	St. Paul Surplus Lines Ins Co	PROF	$26,486		$194,869	A++	Stable	28-May-15
27	000241	Travelers Excess & Surp Lines	PROF	$213,488		$65,340	A++	Stable	28-May-15
28	000060	Liberty Mutual Insurance Cos		$350,326	-19.4%	$97,565			
28	012078	Liberty Surplus Ins Corp	PROF	$350,326		$97,565	A	Stable	24-Sep-14
29	018081	Navigators Insurance Group		$316,220	24.2%	$1,026,915			
29	001825	Navigators Insurance Company	MISC	$27		$893,946	A	Stable	3-Jun-15
29	010761	Navigators Specialty Ins Co	PROF	$316,194		$132,969	A	Stable	3-Jun-15
30	018523	Assurant P&C Group		$296,295	-3.4%	$220,002			
30	002050	Standard Guaranty Ins Co	MISC	$136,887		$160,733	A	Stable	21-Nov-14
30	002861	Voyager Indemnity Ins Co	PROF	$159,409		$59,270	A	Stable	21-Nov-14
31	018753	Munich-American Hldng Corp Cos		$296,040	6.9%	$242,655			
31	013062	Amer Modern Surpl Lines Ins Co	PROF	$31,834		$26,683	A+	Stable	13-Nov-14

Appendix A

U.S. Surplus Lines - Top 50 Groups, 2014

Ranked by direct premims written
(USD Thousands)

Rank	A.M. Best #	Group Name	Type of Company	Surplus Lines DPW	Year/Year Change in DPW	Total Group PHS	Best's Financial Strength Rating*	Financial Strength Rating Outlook / Implications	Rating Effective Date
31	002666	American Modern Select Ins Co	MISC	$844		$44,879	A+	Stable	13-Nov-14
31	003763	American Western Home Ins Co	PROF	$53,791		$63,228	A+	Stable	13-Nov-14
31	014838	HSB Specialty Insurance Co	PROF	$4,433		$49,794	A++	Stable	6-Feb-15
31	012170	Princeton Excess & Surp Lines	PROF	$205,138		$58,070	A+	Stable	13-Nov-14
32	002946	Western World Insurance Group		$277,071	13.4%	$624,510			
32	002598	Tudor Insurance Company	PROF	$62,313		$172,421	A	Stable	6-Nov-14
32	003132	Western World Insurance Co	PROF	$214,758		$452,089	A	Stable	6-Nov-14
33	018620	Endurance Specialty Group		$268,714	39.8%	$90,259			
33	013033	Endurance American Spec Ins Co	PROF	$268,714		$90,259	A	Stable	28-May-15
34	003883	RLI Group		$259,933	-0.2%	$461,140			
34	002591	Mt Hawley Insurance Company	PROF	$259,933		$461,140	A+	Stable	4-Jun-15
35	018626	James River Group		$252,707	31.3%	$174,119			
35	013985	James River Casualty Company	PROF	$5,971		$15,862	A-	Positive	26-Jun-15
35	012604	James River Insurance Co	PROF	$246,736		$158,257	A-	Positive	26-Jun-15
36	005696	Everest Re U.S. Group		$225,986	27.6%	$78,588			
36	012096	Everest Indemnity Insurance Co	PROF	$225,377		$57,548	A+	Stable	25-Jul-14
36	011197	Everest Security Insurance Co	MISC	$609		$21,040	A+	Stable	25-Jul-14
37	018490	White Mountains Insurance Grp		$225,063	1.5%	$162,199			
37	010604	Homeland Ins Co of NY	PROF	$200,571		$111,328	A	Stable	3-Oct-14
37	014398	Homeland Insurance Company DE	PROF	$24,492		$50,872	A	Stable	3-Oct-14
38	000856	State Auto Insurance Companies		$222,567	24.0%	$99,813			
38	013023	Rockhill Insurance Company	PROF	$222,567		$99,813	A-	Stable	28-Apr-15
39	000897	IFG Companies		$190,370	-16.3%	$455,048			
39	000709	Burlington Insurance Company	PROF	$187,960		$180,745	A	Stable	12-Jun-15
39	012242	Guilford Insurance Company	PROF	$2,410		$274,304	A	Stable	12-Jun-15
40	018717	HIIG Group		$182,997	11.0%	$280,336			
40	013825	Houston Specialty Insurance Co	PROF	$121,821		$263,641	A-	Stable	23-Jan-15
40	014363	Oklahoma Specialty Ins Co	PROF	$61,176		$16,695	A-	Stable	23-Jan-15
41	018669	Global Indemnity Group		$177,300	11.2%	$369,462			
41	003674	Penn-America Insurance Company	PROF	$69,751		$84,418	A	Stable	12-Jun-15
41	011460	Penn-Patriot Insurance Company	PROF	$1,985		$20,615	A	Stable	12-Jun-15
41	012050	Penn-Star Insurance Company	PROF	$44,648		$49,300	A	Stable	12-Jun-15
41	003128	United National Insurance Co	PROF	$58,497		$195,876	A	Stable	12-Jun-15
41	000447	United National Specialty Ins	MISC	$2,418		$19,254	A	Stable	12-Jun-15
42	003873	SCOR U S Group		$174,815	27.8%	$51,676			
42	002837	General Security Indem Co AZ	PROF	$174,815		$51,676	A	Stable	1-Oct-14
43	004294	The Cincinnati Insurance Cos		$162,412	19.1%	$265,556			
43	013843	Cincinnati Specialty Undrs Ins	PROF	$162,412		$265,556	A	Stable	12-Dec-14
44	018733	Philadelphia Ins/Tokio Mar Grp		$161,444	58.6%	$173,937			
44	000763	Tokio Marine Specialty Ins Co	PROF	$161,444		$173,937	A++	Stable	4-Jun-15
45	014027	Kinsale Insurance Company		$157,917	27.2%	$104,101			
45	014027	Kinsale Insurance Company	PROF	$157,917		$104,101	A-	Stable	9-Apr-15
46	018653	Maxum Specialty Insurance Grp		$151,425	5.1%	$109,724			
46	012563	Maxum Indemnity Company	PROF	$151,425		$109,724	A-	Negative	22-May-15
47	018567	IAT Insurance Group		$150,163	5.2%	$286,247			
47	011774	Acceptance Casualty Ins Co	PROF	$7,803		$49,427	A-	Stable	11-Jun-15
47	010611	Acceptance Indemnity Ins Co	PROF	$93,423		$129,182	A-	Stable	11-Jun-15
47	000975	Wilshire Insurance Company	MISC	$48,937		$107,639	A-	Stable	11-Jun-15
48	003926	Selective Insurance Group		$147,070	14.0%	$66,794			
48	013842	Mesa Underwriters Spec Ins Co	PROF	$147,070		$66,794	A	Stable	28-May-15
49	025045	GeoVera U.S. Insurance Group		$141,024	-4.9%	$22,359			
48	011678	GeoVera Specialty Insurance Co	PROF	$141,024		$22,359	A	Stable	5-Jun-15
50	018587	Atain Insurance Companies		$110,008	25.8%	$199,155			
50	012422	Atain Insurance Company	PROF	$4,857		$45,743	A	Stable	12-Jun-15
50	002842	Atain Specialty Insurance Co.	PROF	$105,152		$153,412	A	Stable	12-Jun-15

* Ratings are as of August 21, 2015
Source: A.M. Best data and research

Apendix B

U.S. Domestic Professional Surplus Lines – Entrances & Exits, 2010-2014

X denotes domestic professional surplus companies, defined as companies with direct premium from surplus lines business greater than 50% of total premium.

Company Name	2010	2011	2012	2013	2014
Acceptance Casualty Insurance Co			X	X	X
Acceptance Indemnity Insurance Co	X	X	X	X	X
Admiral Insurance Co	X	X	X	X	X
Adriatic Insurance Co	X	X	X	X	X
AIG Specialty Insurance Co	X	X	X	X	X
AIX Specialty Insurance Co	X	X	X	X	X
Allianz Underwriters Insurance Co	X	X	X	X	X
Allied World Asr Co (US) Inc			X	X	X
Allied World Surplus Lines Ins	X	X	X	X	X
Alterra Excess & Surplus Ins	X	X	X	X	X
American Empire Surplus Lines	X		X	X	X
American Modern Surpl Lines Ins Co	X	X	X	X	X
American Mutual Share Ins Corp	X	X	X	X	X
American Safety Indemnity Co	X	X	X	X	X
American Safety Insurance Co	X	X	X	X	X
American Western Home Ins Co	X	X	X	X	X
Appalachian Insurance Co	X	X	X	X	X
Arch Excess & Surplus Co	X	X			
Arch Specialty Insurance Co	X	X	X	X	X
Aspen Specialty Insurance Co	X	X	X	X	X
Associated Industries Insurance Co			X	X	
Associated International Ins	X	X	X	X	X
Atain Insurance Co	X	X	X	X	X
Atain Specialty Insurance Co.	X	X	X	X	X
Atlantic Casualty Insurance Co	X	X	X	X	X
AXIS Specialty Insurance Co	X				
AXIS Surplus Insurance Co	X	X	X	X	X
Berkley Assurance Co		X	X	X	X
Berkley Regional Specialty Ins	X	X	X	X	X
Burlington Insurance Co	X	X	X	X	X
Canal Indemnity Co	X	X	X	X	X
Canopius US Insurance, Inc.			X	X	X
Capitol Specialty Insurance Corp	X	X	X	X	X
Catlin Specialty Insurance Co	X	X	X	X	X
Century Surety Co	X	X	X	X	X
Chubb Custom Insurance Co	X	X	X	X	
CIM Insurance Corporation	X	X	X	X	
Cincinnati Specialty Undrs Ins	X	X	X	X	X
Clarendon America Insurance Co	X	X			
Colony Insurance Co	X	X	X	X	X
Columbia Casualty Co	X	X	X	X	X
Companion Specialty Ins Co	X	X	X	X	
Covington Specialty Ins Co	X	X	X	X	X
Crum & Forster Specialty Ins	X	X	X	X	X
CUMIS Specialty Ins Co Inc	X	X	X	X	X
Discover Specialty Insurance Co	X	X	X	X	
Empire Indemnity Insurance Co	X	X	X	X	X
Endurance American Spec Ins Co	X	X	X	X	X
Essex Insurance Co	X	X	X	X	X
Evanston Insurance Co	X	X	X	X	X
Everest Indemnity Insurance Co	X	X	X	X	X
Executive Risk Specialty Insurance	X	X	X	X	X
Fair American Select Ins Co					X
Fireman's Fund Ins Co of OH	X	X	X	X	X
First Financial Insurance Co	X	X	X	X	

Company Name	2010	2011	2012	2013	2014
First Mercury Insurance Co	X	X	X	X	X
First Specialty Insurance Corp	X	X	X	X	X
Gemini Insurance Co	X	X	X	X	X
General Security Indem Co AZ	X	X	X	X	X
General Star Indemnity Co	X	X	X	X	X
Genesis Indemnity Insurance Co	X				
GeoVera Specialty Insurance Co	X	X	X	X	X
GNY Custom Insurance Co	X	X	X	X	X
Gotham Insurance Co	X	X	X	X	X
Great Amer Protection Insurance Co			X	X	X
Great American E&S Insurance Co	X	X	X	X	X
Great American Fidelity Insurance Co	X	X	X	X	X
GuideOneNational Insurance Co				X	X
Guilford Insurance Co	X	X	X	X	X
Gulf Underwriters Insurance Co	X		X		
Hallmark Specialty Insurance Co	X	X	X	X	X
HCC Specialty Insurance Co	X	X	X	X	X
Hermitage Insurance Co			X		
Homeland Insurance Co of NY	X	X	X	X	X
Homeland Insurance Company DE				X	X
Houston Casualty Co	X	X	X	X	X
Houston Specialty Insurance Co	X	X	X	X	X
HSB Specialty insurance Co				X	X
Hudson Excess Insurance Co				X	X
Hudson Specialty Insurance Co	X	X	X	X	X
Illinois Union Insurance Co	X	X	X	X	X
Indian Harbor Insurance Co	X	X	X	X	X
Interstate Fire & Casualty Co	X	X	X	X	X
Ironshore Specialty Insurance Co	X	X	X	X	X
James River Casualty Co	X	X	X	X	X
James River Insurance Co	X	X	X	X	X
Kinsale Insurance Co	X	X	X	X	X
Knight Specialty Insurance Co					X
Landmark American Ins Co	X	X	X	X	X
Landmark Insurance Co	X	X			
Lexington Insurance Co	X	X	X	X	X
Liberty Surplus Ins Corp	X	X	X	X	X
Maiden Specialty Insurance Co	X	X	X	X	X
Maxum Indemnity Co	X	X	X	X	X
Medical Security Insurance Co				X	X
Merchants National Ins Co	X	X	X	X	X
Mesa Underwriters Spec Ins Co			X	X	X
Mid-Continent Excess & Surplus			X	X	X
Montpelier US Insurance Co	X				
MSA Insurance Co	X	X	X	X	X
MSI Preferred Insurance Co	X	X	X		
Mt Hawley Insurance Co	X	X	X	X	X
Mt Vernon Fire Insurance Co	X	X	X	X	X
NAMIC Insurance Co, Inc	X	X	X	X	X
National Fire & Marine Ins Co	X	X	X	X	X
National Guaranty Ins Co of Vermont	X	X	X	X	X
Nautilus Insurance Co	X	X	X	X	X
Navigators Specialty Ins Co	X	X	X	X	X
Nevada Capital Insurance Co				X	
Newport Insurance Co			X		

Apendix B

U.S. Domestic Professional Surplus Lines – Entrances & Exits, 2010-2014

X denotes domestic professional surplus companies, defined as companies with direct premium from surplus lines business greater than 50% of total premium.

Company Name	2010	2011	2012	2013	2014
Noetic Specialty Insurance Co	X	X		X	X
North American Capacity Ins Co	X	X	X	X	X
North Light Specialty Insurance Co	X	X	X	X	X
Northfield Insurance co				X	X
Nutmeg Insurance Co	X	X			X
Oklahoma Specialty Ins Co				X	X
Old Guard Insurance Co	X	X	X		
Old Republic Union Ins Co	X	X	X	X	X
Omega US Insurance Inc	X	X			
Pacific Insurance Co, Ltd	X	X	X	X	X
Peleus Insurance Company	X	X	X	X	X
Penn-America Insurance Co	X	X	X	X	X
Penn-Patriot Insurance Co	X	X	X	X	X
Penn-Star Insurance Co	X	X	X	X	X
Philadelphia Insurance Co	X	X			
Prime Insurance Co	X	X	X	X	X
Prime Insurance Syndicate Inc					
Princeton Excess & Surp Lines	X	X	X	X	X
ProAssurance Specialty Ins Co	X	X	X	X	X
Professional Security Ins Co	X			X	X
Professional Underwriters Liability	X	X	X		
Protective Specialty Ins Co		X	X	X	X
QBE Specialty Insurance Co	X	X	X	X	X
Rainier Insurance Co					
Republic-Vanguard Ins Co	X	X	X	X	X
Rockhill Insurance Co	X	X	X	X	X
SAFECO Surplus Lines Insurance Co	X	X			
Sagamore Insurance Co		X	X		
Savers Property & Casualty Ins Co			X		
Scottsdale Insurance Co	X	X	X	X	X
Scottsdale Surplus Lines Ins	X	X	X	X	X
Seneca Specialty Ins Co	X	X	X	X	X
Southwest Marine & General	X	X	X	X	X
SPARTA Specialty Insurance Co			X	X	X
Specialty Surplus Insurance Co	X				
St. Paul Fire & Casualty Ins	X	X	X	X	
St. Paul Surplus Lines Ins Co	X	X	X	X	X
Standard Guaranty Ins Co	X	X	X		
Starr Surplus Lines Ins Co	X	X	X	X	X
Steadfast Insurance Co	X	X	X	X	X
TDC Specialty Insurance Co				X	X
TM Specialty Insurance Co	X	X	X		
Tokio Marine Specialty Ins Co			X	X	X
Torus Specialty Insurance Co	X	X	X	X	X
Traders & General Ins Co	X	X	X		
Travelers Excess & Surp Lines	X	X	X	X	X
TrustStar Insurance Co			X		
Tudor Insurance Co	X	X	X	X	X
United National Insurance Co	X	X	X	X	X
United Specialty Insurance Co	X	X	X	X	X
US Underwriters Insurance Co	X	X	X	X	X
Utica Specialty Risk Ins Co	X	X	X	X	
Valiant Specialty Insurance Co	X	X	X		
Voyager Indemnity Ins Co	X	X	X	X	X
Westchester Surplus Lines Ins	X	X	X	X	X
Western Heritage Insurance Co	X	X	X	X	X
Western World Insurance Co	X	X	X	X	X
Wilshire Insurance Co			X		
XL Select Insurance Co	X	X	X	X	X

Source: A.M. Best data and research

Appendix C
U.S. State Survey: Regulated & Unregulated Alien Lists

State	Regulated Alien List Maintained	Unregulated Alien List Maintained	Alien Insolvencies Tracked	Fraud Unit
Alabama^	No	No	No	Yes
Alaska^	Yes**	No	No	Yes
Arizona^	No**	No	No	No
Arkansas	Yes**	No	No	Yes
California	Yes****	No	No	Yes
Colorado^	Yes	No	No	Yes
Connecticut	No	No	No	Yes
Delaware	Yes**	No	No	No
Dist of Columbia	No	No	No	No
Florida	Yes (1)	Yes (2)	No (3)	Yes (4)
Georgia	Yes**	No	No	Yes
Hawaii^	Yes**	No	No	No
Idaho	Yes*	No	Yes	Yes
Illinois	No	Yes	No	Yes
Indiana	Yes*	No	No	No
Iowa^	Yes*	No	No	No
Kansas^	Yes*	No	No	Yes
Kentucky	Yes*	No	No	Yes
Louisiana^	Yes	No	No	Yes
Maine	Yes	No	No	No
Maryland^	Yes*	No	No	No
Massachusetts	Yes**	No	No	Yes
Michigan (5)	Yes	No	No	No
Minnesota	Yes	No	No	Yes
Mississippi^	Yes**	No	No	Yes
Missouri	Yes*	No	No	Yes
Montana^	No	Yes	No	Yes
Nebraska^	No	No	No	Yes
Nevada	Yes**	No	No	Yes
New Hampshire	Yes**	No	No	No
New Jersey^	No	No	No	No
New Mexico	Yes*	No	No	No
New York^	No	No	Yes	Yes
North Carolina^	Yes (6)	No (6)	No	Yes
North Dakota	Yes**	No	No	Yes
Ohio^	Yes**	Yes	No	No
Oklahoma^	Yes	No	No	No
Oregon	No	No	No	No
Pennsylvania	No***	No	Yes	Yes
Puerto Rico^	Yes	No	No	No
Rhode Island	Yes**	No	No	No
South Carolina	No	No	No	No
South Dakota	No	No	No	Yes
Tennessee	No	No	No	No
Texas	Yes**	No	No	Yes
Utah	Yes**	No	Yes	Yes
Vermont	No	No	No	No
Virginia^	No	No	No	No
Washington	No	No	No	Yes
West Virginia	Yes*	No	No	Yes
Wisconsin	No	No	No	No
Wyoming^	Yes**	No	No	No

^ Indicates state's response is as of August 2014. These states have not responded as of August 20, 2015.
* Uses the "white list" from the International Insurers Department of the National Association of Insurance Commissioners.
Source: A.M. Best Co., as of August 20, 2015.
** Uses the "Quarterly Listing of Alien Insurers" from the International Insurers Department of the NAIC to qualify aliens for the ADOI "List of Qualified Unauthorized Surplus Lines Insurers."
*** The Pennsylvania Insurance department maintains a listing of all eligible surplus lines insurers including alien insurers.
**** Uses the "Quarterly Listing of Alien Insurers" from the International Insurers Department of the NAIC
(1) The Florida Office of Insurance Regulation maintains a current listing of all surplus lines insurers including aliens.
(2) The Florida Office of Insurance regulation maintains a list of Federally Authorized Insurers that claim federal exemption (IID list)
(3) An alien insurer insolvency is not tracked once it has become insolvent or disappeared.
(4) There is a unit for unlicensed/unapproved entities that is operated out of the Market Conduct section of the Florida Office of Insurance Regulation. There is no routine monitoring of unregulated alien insurers.
(5) The Michigan Office of Financial and Insurance regulation maintains a current listing of all eligible unauthorized surplus lines including aliens.
(6) The North Carolina Department of Insurance maintains a current listing of all surplus lines carriers that have applied and been approved for regulation, including aliens.

Appendix D
State Survey: Capital & Surplus Requirements for Surplus Lines Companies

State	Domestic Company Minimum Surplus	Alien Company Minimum Surplus	Pending Revisions
Alabama^	$5,000,000	$2,500,000 (1) & $15,000,000	No
Alaska^	$15,000,000	$15,000,000 & 2,500,000 (1)	No
Arizona^	$15,000,000	$15,000,000(8)/ $5,400,000 (1)	No
Arkansas	$20,000,000	N/A	No
California	45,000,000 (2)	(8)	No
Colorado^	$15,000,000	$5,400,000	No
Connecticut	$15,000,000	$15,000,000 (10)	No
Delaware	$15,000,000	$15,000,000	No
Dist of Columbia	$300,000	$300,000	No
Florida	$15,000,000	$15,000,000 (3)	No
Georgia	$4,500,000	$10,000,000 / $10,000,000(1)	No
Hawaii^	$15,000,000	$5,400,000 (1)	No
Idaho	$2,000,000	$15,000,000	No
Illinois	$15,000,000	$15,000,000	No
Indiana	$15,000,000	$15,000,000	No
Iowa^	$15,000,000	N/A	
Kansas^	$4,500,000	$50,000,000	No
Kentucky	$6,000,000	$5,400,000 (3)	No
Louisiana^	$15,000,000	$15,000,000 (8)	No
Maine	$4,500,000	Listed with NAIC International Insurers Department (9)	No
Maryland^	$15,000,000	N/A	No
Massachusetts	$20,000,000	$20,000,000	Yes
Michigan	$7,500,000	$15,000,000 (10)	Yes
Minnesota	$15,000,000	$15,000,000	No
Mississippi^	$1,500,000	$15000000 & 5,400,000 (3)	No
Missouri	$15,000,000	$15,000,000	Yes
Montana^	$15,000,000	$15,000,000	Yes
Nebraska^	$15,000,000	(8)	No
Nevada	$15,000,000	$5,400,000 / 100,000,000 (4)	Yes
New Hampshire	$15,000,000	N/A	No
New Jersey^	$15,000,000	$15,000,000 (6)	N/A
New Mexico	15,000,000 (5)	$15,000,000 (5)	N/A
New York^	$45,000,000	$45,000,000 (9)	No
North Carolina^	$15,000,000	$15,000,000 (11)	No
North Dakota	$15,000,000	$15,000,000	No
Ohio^	$5,000,000	$15,000,000	No
Oklahoma^	$15,000,000	$15,000,000	No
Oregon	$5,000,000	15,000,000 / $5,400,000 (3)	No (6)
Pennsylvania	$15,000,000/ $4,500,000	(8)	No
Puerto Rico^	$300,000 / $1,000,000	$300,000 / $1,000,000	No
Rhode Island	$15,000,000	$15,000,000	No
South Carolina	$15,000,000	$15,000,000	No
South Dakota	$500,000	$500,000	No
Tennessee	$15,000,000	Listed with NAIC International Insurers Department	No
Texas	$15,000,000	(8)	No
Utah	$2,500,000 (1)	$15,000,000	No
Vermont	$15,000,000	$15,000,000	No
Virginia^	$1,000,000/ $3,000,000	Deemed Approval (7)	No
Washington	$15,000,000	(10)	No
West Virginia	$15,000,000	$15,000,000	No
Wisconsin	N/A	N/A	No
Wyoming	$15,000,000	$15,000,000	No

^ Indicates state's response is as of August 2014. These states have not responded as of August 20, 2015.
(1) Trust Fund
(2) Minimum surplus phase-in period for US-domiciled nonadmitted insurers currently on the California list of eligible surplus lines insurers that did not meet the $45 million minimum capital and surplus requirements as of Jan. 1, 2011; the insurer must have capital and surplus if $45 million by December 31, 2013.
(3) In addition, alien carriers required to maintain $5.4 million trust fund in the United States.
(4) Lloyd's
(5) Due to Dodd-Frank
(6) This law became effective January 1, 2012.
(7) Insurers appearing on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC deemed approved in Virginia.
(8) Alien company must be listed on the Quarterly Listing of Alien Insurers maintained by the International Insurance Department of the NAIC.
(9) Due to Dodd-Frank; NAIC Quarterly Listing of Alien Insurers is used for verification purposes. As of January 1, 2013, new alien insurers require $45 million.
(10) Due to Dodd-Frank; NAIC Quarterly Listing of Alien Insurers is used for verification purposes.
(11) For those alien surplus lines carries that have applied and been approved for registration in North Carolina. Additionally, those insurers listed on the NAIC Quarterly Listing of Alien Insurers are deemed eligible in North Carolina.
Source: A.M. Best Co., as of July 17, 2015.

Appendix E

State Survey: Stamping Office & Multi State Taxation

State	Stamping Office	Premium Tax	Stamping Fee	Tax Allocated	Procurement Tax Applies	Procurement Monitored
Alabama^	No	6.00%	No	No	Yes	No
Alaska^	No	2.70%	1.00%	No	Yes	Insured Reports
Arizona^	Yes	3.00%	0.20%	No	No	No
Arkansas	No	4.00%	No	Yes	Yes	Yes
California	Yes	3.00%	0.20%	No	Yes (1)	Yes (1)
Colorado^	No	3.00%	No	Yes	Yes	Yes
Connecticut	No	4.00%	No	No	Yes	Yes
Delaware	No	3.00%	No	No	Yes	Insured Reports
Dist of Columbia	No	2.00%	No	Yes	Yes	No
Florida	Yes	5.00%	0.175%	Yes (3)	Yes	Yes
Georgia	No	4.00%	No	No	Yes	Insured Reports
Hawaii^	No	4.68%	No	Yes	No	No
Idaho	Yes	1.50%	0.25%	No	Yes	Insured Reports
Illinois	Yes	3.50%	0.20%	Yes	No	No
Indiana	No	2.50%	No	No	Yes	Yes
Iowa^	No	1.00%	No	No	Yes	No
Kansas^	No	6.00%	No	No	No	No
Kentucky	No	3.00%	No	Yes	No	Yes
Louisiana^	No	4.85%	No	Yes	Yes	Insured Reports
Maine	No	3.00%	No	No	Yes	Yes
Maryland^	No	3.00%	No	N/A	Yes	Insured Reports
Massachusetts	No	4.00%	No	Yes	No	No
Michigan*	No	2.00%	No	No	No	Yes-Insured Reports
Minnesota	Yes	3.00%	0.06%	No	Yes	Insured Reports
Mississippi^	Yes	4.00%	0.25%	Yes	Yes	Yes
Missouri	No	5.00%	No	No	Yes	Yes
Montana**^	No	2.75%	0.00%	Yes	No	No
Nebraska^	No	3% (9)	No	No (6)	No	No
Nevada	Yes	3.50%	0.40%	No	Yes	Yes
New Hampshire	No	3.00%	No	Yes	Yes	Yes
New Jersey^	No	5.00%	No	No*	Yes (1)	No
New Mexico	No	3.00%	N/A	N/A	No	No
New York^	Yes	3.60%	0.18%	No	Yes	Yes (2)
North Carolina^	No	5.00%	No	No	Yes	Insured Reports
North Dakota	No	1.75%	No	No	Yes	No
Ohio^	No	5.00%	No	No	Yes	No
Oklahoma^	No	6.00%	No	Yes	No	Insured Reports
Oregon	Yes	2.3% (4)	$15.00	No	Yes	No
Pennsylvania	Yes	3.00%	$25.00	No	Yes	Insured Reports
Puerto Rico^	No	9.00%	No	Yes	Yes	Yes
Rhode Island (7)	No	2.00%	No	No	No	No
South Carolina	No	4.00%	No	No	No	No
South Dakota	No	2.5% - 3.0%	No	Yes (8)	Yes	Yes
Tennessee	No	5.00%	No	No	No	No
Texas	Yes	4.85%	0.06%	No	Yes	Insured Reports
Utah	Yes	4.25%	0.25%	Yes	Yes	No
Vermont	No	3.00%	No	N/A	Yes	Yes
Virginia^	No	2.25%	No	No	No	No
Washington	Yes	2.00%	0.10%	No	Yes	Yes

Appendix E
State Survey: Stamping Office & Multi State Taxation

State	Stamping Office	Premium Tax	Stamping Fee	Tax Allocated	Procurement Tax Applies	Procurement Monitored
West Virginia	No	4.55%	No	No	No	No
Wisconsin	No	3.00%	No	No	Yes (5)	No
Wyoming	No	3.00%	No	Yes	Yes	Yes

^ Indicates response is as of August 2014. These states have not responded as of August 20, 2015.
(1) Not by DOI; handled by state franchise tax board.
(2) Not by DOI; handled by Department of Revenue Services/Taxation.
(3) Florida has joined the tax sharing agreement of NIMA. Since 7/1/12, all Florida home state policies get filed at the NIMA Clearinghouse and other NIMA participants will get their portion of the allocated premium. Non-participating state's premium will be retained by the home state.
(4) This amount includes .3% collected for Oregon Fire Marshalls' office.
(5) Tax now 3% on ocean marine business.
(6) Tax payable is the sum of 3% on portion of gross premiums allocated to Nebraska plus other state's applicable tax rates applicable on the portion of the premiums allocated to other states.
(7) Premium taxes are handled by the Division of Taxation.
(8) South Dakota joined the tax sharing agreement of NIMA as of 7/1/12. All of South Dakota's home state policies get filed at the NIMA Clearinghouse and premium is allocated with other participating NIMA states. Non-NIMA states' premium is retained by the home state of the insured.
* In Michigan, a 0.5% regulatory fee applies in addition to the premium tax.
** Assess a 1% stamping fee on paper filings and a 1/2% (0.005) stamping fee on electronically filed policies. No longer necessary for Montana. Effective 1/1/2012, Montana's stamping fee is 0.00% for electronically filed policies and endorsements and paper filings have a 0.25% stamping fee.
Source: A.M. Best Company, as of August 20, 2015.

Published by A.M. Best Company
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Testimony of

Teresa D. Miller

Commissioner

Pennsylvania Insurance Department

On Behalf of the National Association of Insurance

Commissioners

Before the

Subcommittee on Housing and Insurance

Committee on Financial Services

United States House of Representatives

Regarding:

How to Create a More Robust and Private Flood Insurance
Marketplace

January 13, 2016

Introduction

Chairman Luetkemeyer, Ranking Member Cleaver, and members of the Subcommittee, thank you for the invitation to testify today. My name is Teresa Miller. I serve as the Commissioner of the Insurance Department for the Commonwealth of Pennsylvania and I am here on behalf of the National Association of Insurance Commissioners (NAIC).[1] I also serve as the Chair of the NAIC's Property and Casualty (C) Committee. On behalf of my fellow state insurance regulators, I appreciate the opportunity to offer our views and perspective on the Flood Insurance Market Parity and Modernization Act (H.R. 2901) and related issues surrounding the development of a private flood insurance market.

Floods are the most common natural disaster in the United States and all 50 states have experienced floods or flash floods in the past five years.[2] State insurance regulators are keenly aware of the devastating effects floods have on constituents in our states and believe it is critical that flood insurance is available and affordable to protect homes, businesses, and personal property, providing peace of mind. Insurance consumers should have access to multiple options in order to find their preferred coverage and price, and facilitating increased private sector involvement in the sale of flood insurance will help promote these consumer choices and spur competition.

The NAIC supports the Flood Insurance Market Parity and Modernization Act (H.R. 2901) as introduced, and commends Congressmen Ross and Murphy for developing this legislation to help encourage greater growth in the private flood insurance market, provide consumers with additional choices for flood insurance products, and make clear that the state insurance regulatory authorities that have long protected policyholders and allowed for the growth of other vibrant insurance markets will apply to private flood insurance.

Private Flood Insurance Market

In 1968, Congress established the National Flood Insurance Program (NFIP) in response to the lack of availability of private insurance and continued increases in federal disaster assistance due to floods. At the time, flooding was viewed as an uninsurable risk and coverage was virtually unavailable from private insurance markets, particularly in the wake of frequent widespread flooding along the Mississippi River in the early 1960s. In recent years, more sophisticated risk mapping and modeling have developed, enabling the private market to more accurately price the risk and generating new interest among private insurers to provide such coverage. Access to NFIP policy and claims data would also help private insurers assess flood risks and may stimulate the market even more.

While there is limited interest from the admitted insurance market at this time, there is a growing appetite in the surplus lines market to provide private flood insurance coverage. Like many types of new coverages, private flood coverage is being developed and offered first by surplus lines

[1] The NAIC is the United States standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, we establish standards and best practices, conduct peer review, and coordinate our regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

[2] https://www.floodsmart.gov/floodsmart/pages/flood_facts.jsp

insurers, which typically insure unique or otherwise difficult to underwrite risks that the admitted market is, at least initially, reluctant to insure. Typically, after a new coverage has proven itself profitable in the surplus lines market and sufficient data has been gathered to provide a sound basis for rate development, the coverage tends to become a standard product in the admitted market. Ideally, private flood coverage will follow this path and admitted carriers will eventually engage in this market.

Facilitating the entry of additional carriers into the market will provide consumers with access to additional options for flood insurance products. In Pennsylvania, competition is proving to be good for consumers, providing more choices and better prices. At least five surplus lines carriers sold flood insurance to homeowners in Pennsylvania in 2015, and have written nearly 1,000 policies. We have also started seeing licensed insurers write the coverage, but they currently serve very limited markets.

We are finding in many cases that private carriers are willing to offer comparable coverage at substantially lower cost than the NFIP. In Pennsylvania, one property owner would have paid a $7,500 annual premium with the federal program, but found private coverage for $1,415. Another homeowner was quoted a $6,000 annual premium by NFIP, but found a surplus lines policy for $900. Yet another homeowner's story is similar to many in Pennsylvania. This individual lived in his home for many years without experiencing a flood, and without flood insurance, but recently was told his property was now in a flood plain because of re-mapping by the Federal Emergency Management Agency (FEMA). NFIP coverage would have cost him $3,000 a year. He is paying $1,000 a year for a surplus lines policy.

These are just a few examples. Flood insurance is a big issue in Pennsylvania. FEMA statistics show from 2006 through 2014, Pennsylvania property owners filed more than 18,000 claims with the NFIP, for more than $551 million in damages, with claims coming from 66 of the state's 67 counties.

Governor Tom Wolf has made consumer protection the top priority for the Insurance Department. I wholeheartedly endorse this legislation, and believe encouraging more private insurers to enter the flood insurance market will provide homeowners needed coverage, often at greatly reduced costs. Over time, this additional competition and shift of risk from a federal program to the private market could help lessen the exposure of U.S. taxpayers to the types of catastrophic flood losses that now reside as unpaid debt on the NFIP's books.

Regulation of Surplus Lines Market

In the case of private flood policies written by surplus lines carriers, state insurance regulators will continue to oversee the surplus lines insurance marketplace by imposing capital and surplus requirements on eligible U.S.-based carriers and licensing and supervising surplus lines brokers. Surplus lines insurers that are domiciled in a U.S. state are regulated by their state of domicile for financial solvency and market conduct. Surplus lines insurers domiciled outside the U.S. may apply for inclusion in the NAIC's Quarterly Listing of Alien Insurers. The carriers listed on the NAIC Quarterly Listing of Alien Insurers are subject to capital and surplus requirements, a requirement to maintain U.S. trust accounts, and character, trustworthiness and integrity requirements.

In addition, the insurance regulator of the state where the policyholder resides (the home state of the insured) has authority over the placement of the insurance by a surplus lines broker and enforces the requirements relating to the eligibility of the surplus lines carrier to write policies in that state. The insurance regulator can potentially sanction the surplus lines broker, revoke their license, and hold them liable for the full amount of the policy.

In Pennsylvania, the Insurance Department can declare a surplus lines insurer ineligible to do business in the state, if the regulator finds the insurer is in unsound financial condition, has willfully violated the laws of the state, or does not make reasonably prompt payment of claims in Pennsylvania or elsewhere. The Insurance Department may also suspend, revoke, or refuse to renew the license of a surplus lines broker for various reasons, including failure to make and file required reports, failure to collect or transmit required tax on surplus lines premiums, failure to remit premiums due insurers or return premiums due insureds within reasonable time limits, or for any other cause for which action can be taken against an insurance producer's license. In Pennsylvania, the Insurance Department also has authority to assess a civil penalty up to $2,000 for the first offense, and up to $4,000 for each succeeding offense against anyone violating the Commonwealth's insurance laws.[3]

Like any other insurance market, as the private flood insurance market grows and more companies offer coverage including admitted carriers, we anticipate the regulation will continue to evolve to meet the size and breadth of the market as well as the needs of insurance consumers. State insurance regulators have a long history of carefully monitoring the emergence and innovation of new products and coverages, and tailoring regulation over time to ensure consumers are appropriately protected.

Flood Insurance Market Parity and Modernization Act (H.R. 2901)

In order to help further facilitate the development of the private flood market, changes must be made to address some of the unintended consequences resulting from the Biggert-Waters Flood Insurance Reform Act of 2012. Although one of its objectives was to provide opportunities for the growth of the private market as an alternative to the NFIP, the definition of and regulatory environment surrounding private flood insurance created by the Biggert-Waters Act is at odds with this objective and makes it more difficult for insurance regulators to protect consumers and ensure availability of the product.

Critical Regulatory Clarifications

The Biggert-Waters Act empowered federal banking and housing regulators and the government-sponsored enterprises (GSEs) to apply their own requirements related to the financial solvency, strength, or claims-paying ability of private insurance companies from which they will accept private flood insurance. This is highly problematic as banking and housing regulators neither have the expertise nor the experience to regulate insurance companies or insurance markets. This also results in duplicative and potentially inconsistent regulatory requirements for insurers and serves as a disincentive for private insurers to consider writing flood insurance coverage.

We understand that it may be appropriate for lending entities and the GSEs to review the financial health of insurers and provide guidelines as to the type of companies its customers may

[3] 40 P.S. §§ 991.1603, 991.1623, 991. 991.1607. 991.1625.

purchase from. However, states have over 140 years of experience supervising the business of insurance, protecting policyholders, and balancing availability with solvency. Banking and housing regulators, whose regulatory objectives (i.e., ensuring the safety and soundness of banks and the GSEs) are fundamentally different than insurance consumer protection and promoting competitive insurance markets, are ill suited to regulate insurance. It is inappropriate for them to be given the authority to substitute their judgement for those charged under law with regulating insurance products and protecting policyholders. In fact, the federal banking regulators acknowledged in their proposed rulemaking on private flood insurance that state insurance regulators, as the primary functional regulators of the sector, may be in the best position to evaluate the condition and ability of a private insurer to offer a flood insurance policy.[4] Moreover, members of this committee have repeatedly affirmed that insurance and its regulation is unique and fundamentally different than banking and other types of financial products.

To address this, H.R. 2901 includes important language clarifying that state insurance regulators have the same authority and discretion to regulate private flood insurance as they have to regulate other similar insurance products and markets. We appreciate these essential clarifications that are critical for state insurance regulators' support for the legislation. Any proposal to amend H.R. 2901 by supplanting state insurance regulators' experience and expertise with those of banking and housing regulators will raise serious concerns for state insurance regulators.

Private Flood Definition

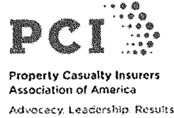
Another impediment for entrants into the private flood market is the definition of private flood insurance included in the Biggert-Waters Act. Private flood insurance is defined in unnecessarily narrow terms with a number of prescriptive conditions. In order for a private market to evolve, we expect insurers would need flexibility to tailor insurance products to meet consumer needs. The Biggert-Waters Act does not allow for this innovation, rather it focuses on ensuring policies do not deviate from its rigid criteria, despite the fact private insurers may be able to offer the consumer additional coverage features or greater limits. H.R. 2901 alleviates these concerns by defining private flood insurance as a policy that is issued by a licensed insurer or eligible surplus lines insurer and provides coverage that is compliant with state laws and regulations. These essential clarifications will assist in removing the restrictive and confusing language in current law to help prompt more insurers to enter this market if they are willing.

Conclusion

As insurance markets evolve, state insurance regulators remain extensively engaged with all relevant stakeholders to promote an optimal regulatory framework—private flood insurance is no exception. As the private flood market develops, we remain committed to effective regulation and to making changes to our regulatory structure when necessary. State insurance regulators will meet any new challenges posed by a dynamic private flood insurance market and we continue to believe that well-regulated markets make for well-protected policyholders. The NAIC appreciates Congressmen Ross and Murphy's leadership in introducing H.R. 2901 and their efforts to encourage greater growth in the private flood insurance market. We thank them

[4] Loans in Areas Having Special Flood Hazards, 78 Fed. Reg. 65,108 (Proposed Oct. 30, 2013).

for their support of state regulation and look forward to continuing to work with the members of this committee as the bill moves forward. Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.



Nathaniel F. Wienecke
Senior Vice President
Federal Government Relations

June 25, 2015

The Honorable Dean Heller
United States Senate
324 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Dennis Ross
United States House of Representatives
229 Cannon House Office Building
Washington, D.C. 20515

The Honorable Jon Tester
United States Senate
311 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Patrick Murphy
United States House of Representatives
211 Cannon House Office Building
Washington, D.C. 20515

Dear Senators Heller and Tester and Representatives Ross and Murphy:

PCI supports the viability of a competitive private insurance market for the benefit of consumers and insurers, and believes that good insurance supervision recognizes the wide variety of property-casualty business models that can increase private competition.

PCI applauds you and your colleagues for introducing the Flood Insurance Market Parity and Modernization Act (S. 1679 and H.R. 2901). PCI remains dedicated to working with House and Senate leaders to strengthen flood protection and risk management options for the millions Americans who depend on flood insurance to protect their homes and businesses. This common sense legislation clarifies the intent of Congress that private flood insurance should be an option available to homeowners.

PCI's members include more than two-thirds of the insurers that partner with the NFIP through the "write-your-own" (WYO) program to sell, service, and administer this federal program. PCI is composed of almost 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write over $183 billion in annual premium, 35 percent of the nation's property casualty insurance. Member companies write 42 percent of the U.S. automobile insurance market, 27 percent of the homeowners market, 32 percent of the commercial property and liability market, and 34 percent of the private workers compensation market.

Sincerely,

Nathaniel F. Wienecke

Building Success. Together.

July 7, 2015

The Honorable Dean Heller
United States Senate
Washington, D.C. 20510

The Honorable Jon Tester
United States Senate
Washington, D.C. 20510

The Honorable Dennis Ross
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick Murphy
U.S. House of Representatives
Washington, D.C. 20515

RE: Support for S. 1679/HR 2901, the Flood Insurance Market Parity and Modernization Act

Dear Senators and Congressmen:

The American Bankers Association and its insurance subsidiary, the American Bankers Insurance Association (ABIA) have long supported both legislative and regulatory efforts to ensure that private flood insurance policies are more readily available as an alternative to the NFIP. We strongly support your efforts to pass legislation making this possible.

Providing consumers with alternatives to the National Flood Insurance Program (NFIP) and driving down flood insurance prices through greater competition is one way to ensure greater protection for consumers against flood damages in the mortgage markets; it is also a significant contribution to the goal of returning the NFIP to more robust fiscal health.

While the Biggert-Waters Act of 2012 and the Homeowners Flood Insurance Affordability Act of 2014 resulted in needed market and regulatory reforms, more work needs to be done to unlock the power of markets to provide affordable flood insurance choices. We look forward to working with you to enhance your bill and to build support for this important legislation.

Sincerely,

James C. Ballentine
Executive Vice President
Congressional Relations and Political Affairs

J. Kevin A. McKechnie
Senior Vice President and Director
Office of Insurance Advocacy

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Fax 202-293-1219
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January 13, 2016

The Honorable Blaine Luetkemeyer
Chairman
Subcommittee on Housing and Insurance
House Financial Services Committee
2128 Rayburn House Office Building
Building
Washington, DC 20515

The Honorable Emanuel Cleaver
Ranking Member
Subcommittee on Housing and Insurance
House Financial Services Committee
4340 Thomas P. O'Neill, Jr., Federal Office

Washington, DC 20515

Dear Chairman Luetkemeyer and Representative Cleaver:

Recent events remind us that communities all across the United States remain vulnerable to severe flooding. Flood insurance plays a critical role in assisting those communities rebound and recover from the damages that flooding causes. As the Subcommittee examines "How to Create a More Robust and Private Flood Insurance Marketplace," I write to express AIA's support for H.R. 2901, the Flood Insurance Market Parity and Modernization Act (FIPMA).

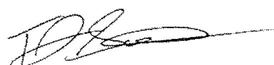
AIA is the leading property-casualty insurance trade organization, representing approximately 325 insurers that write more than $127 billion in premiums each year. AIA member companies offer all types of property-casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance. Several AIA member companies provide flood insurance in partnership with the NFIP through the Write-Your-Own (WYO) program.

The Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12) allows private flood policies to meet the mandatory purchase requirement of the National Flood Insurance Program (NFIP). Unfortunately, some confusion remains and the market has been slow to respond. The Flood Insurance Market Parity and Modernization Act, introduced by Reps. Ross (FL) and Murphy (FL) would clarify this important provision, which is an important step toward the development of a private flood insurance market as a compliment to the NFIP.

Our country's ability to properly manage catastrophic risk depends on our willingness to undertake a thoughtful debate on how best to make our communities more resilient, protect property, and reduce taxpayer exposure. Fostering a private flood insurance market will help achieve these goals by giving consumers options, including the NFIP, to insure against losses from flooding. While providing choice to homeowners is a key component to a competitive marketplace, it is critical that homeowners work with their insurance carriers, and their agents or brokers, to understand the scope of the coverages and to ensure that they have the proper coverage amounts.

On behalf of our member companies, we commend the Committee for addressing this issue and we look forward to working with you to better assist homeowners and communities prepare for and recover from the damages caused by flooding. Please feel free to contact AIA if we can be of any further assistance.

Sincerely,



Thomas Santos
Vice President, Federal Affairs

CC: The Honorable Jeb Hensarling, Chairman, House Committee on Financial Services
The Honorable Maxine Waters, Ranking Member, House Committee on Financial Services
The Honorable Dennis Ross
The Honorable Patrick Murphy

Independent Insurance Agents & Brokers of America, Inc.

20 F Street, N.W., Suite 610, Washington, D.C., 20001, (202) 863-7000

July 13, 2015

Senator Dean Heller
United State Senate
Washington, D.C. 20510

Senator Jon Tester
United States Senate
Washington, D.C. 20510

Congressman Dennis Ross
U.S. House of Representatives
Washington, D.C. 20515

Congressman Patrick Murphy
U.S. House of Representatives
Washington, D.C. 20515

Dear Senator Heller, Senator Tester, Congressman Ross and Congressman Murphy:

On behalf of the Independent Insurance Agents & Brokers of America (Big "I"), we want to express our sincerest appreciation for your introduction of the Flood Insurance Market Parity and Modernization Act of 2015 (S. 1679, H.R. 2901). The Big "I" supports a robust and vibrant National Flood Insurance Program (NFIP) for the millions of consumers across the country who depend on this important risk management tool. This legislation further strengthens the NFIP by increasing the likelihood that private insurers will explore entering the flood insurance market as a complement to the NFIP.

This bill is particularly important to the Big "I" because it clarifies that a private flood policy can satisfy the mandatory purchase requirement for flood insurance under the terms of the NFIP. Mandating that state insurance regulators will be in charge of determining what is "acceptable" private market flood insurance helps to provide additional clarity to program. Finally, ensuring that policyholders will not lose their flood insurance subsidies or their grandfathered status if they decide to move their coverage from the NFIP to a private market policy and one day wish to return to the NFIP, is a vitally important feature to agents and the customers they serve.

The Big "I" is the nation's oldest and largest national association of independent insurance agents representing a network of more than a quarter million agents, brokers and their employees. Ensuring the availability of an efficient and effective flood program is a top priority for our members, and we are grateful for your leadership and advocacy on behalf of this important program.

Sincerely,

Charles E. Symington Jr.
Senior Vice President, External & Government Affairs

February 2, 2016

Representative Blaine Luetkmeyer, Chairman
Representative Emanuel Cleaver, Ranking Member
Subcommittee on Housing and Insurance
Financial Services Committee
United States House of Representatives

By Email

Re: Supplemental Comments to January 13, 2016 Hearing, "How to Create a Robust and Private Flood Insurance Marketplace?

Chairman Luetkmeyer and Ranking Member Cleaver,

Thank you again for inviting me to speak to the subcommittee on flood insurance issues on January 13, 2016. I write to supplement my testimony with comments on issues raised during the hearing.

GSE Authority to Establish Claims Paying Ability of Flood Insurers is Not Insurance Regulation and Does Not Replicate or Usurp State Insurance Regulation

The NAIC testified that that the provisions in the Biggert Waters Act regarding authorizing the Government Sponsored Enterprises to establish criteria for the "financial solvency, strength or claims paying ability of private insurance companies:"

> "This is highly problematic as banking and housing regulators neither have the expertise nor the experience to regulate insurance companies or insurance markets. This also results in duplicative and potentially inconsistent regulatory requirements for insurers and serves as a disincentive for private insurers to consider writing flood insurance coverage."

The NAIC testimony is incorrect. The GSEs already establish the claims-paying ability of insurers – for hazard insurance as well as flood insurance – by simply requiring that the insurers have minimum financial strength ratings from rating agencies. For example, Fannie Mae's Servicing Guide sets out property (hazard) insurance and flood insurance requirements for the type and amount of coverage as well as rating (financial strength) requirements of insurers:

> The property (hazard) insurance policy for the insurable improvements of the property securing any first lien mortgage loan must be written by a carrier that meets one of the following rating requirements, even if it is rated by more than one of the rating agencies.
> **Rating Agency Rating Category**
> A.M. Best Company, Inc. Either a "B" or better Financial Strength Rating in *Best's Insurance Reports*, or an "A" or better Financial Strength Rating and a Financial Size Category of "VIII" or greater in *Best's Insurance Reports Non-US Edition*. Carriers providing coverage for co-op projects must have a general policyholder's rating of "A" and a Financial Size Category of "V" in *Best's Insurance Reports*.
>
> Demotech, Inc. "A" or better rating in *Demotech's Hazard Insurance Financial Stability Ratings*.
>
> Standard & Poor's "BBB" or better Insurer Financial Strength Rating in *Standard & Poor's Ratings Direct Insurance Service*.

Clearly, the GSE's authority and ability to establish requirements for the claims-paying ability of hazard and flood insurers is reasonable and necessary for the GSE's to protect the properties serving as collateral for the loans the GSEs own or insure. This authority clearly has not and does not replicate or usurp state financial solvency regulation. The NAIC's testimony in this regard is not only incorrect, but calls into question the NAIC's understanding of the mortgage markets. The NAIC's testimony that "banking and housing regulators neither have the expertise nor the experience to regulate insurance companies or insurance markets" is particularly ironic given both the NAIC's misunderstanding of this provision in the Biggert Waters Act and the banking and housing regulators' action to stop the abuses in lender-placed insurance markets in the absence of action by the NAIC or all states other than New York, Florida and California.

HR 2091 Will Leave the NFIP in a More Vulnerable Financial Condition and Reduce Funding for Flood Mapping, Loss Mitigation and NFIP Reserves and Treasury Loan Repayment

Congress has tasked the FEMA and the NFIP with numerous goals for flood insurance, including, among others:

- Encourage purchase of flood insurance
- Reduce subsidies and move to actuarial rates
- Work with stakeholders to map floodplains
- Promote loss mitigation

Several of these goals have affected the structure of NFIP rates. When the NFIP sets its rates, it evaluates its risk exposure in flood zones in 30 categories, ranging from lowest flood risk (and expected claim cost) to highest. In an effort to meet Congressional intent to broaden flood participation, the NFIP averages the expected claims for the 30 risk categories to develop a single rate across all 30 classes instead of setting 30 different rates which would range from lower than average to higher than average.

In the homeowners insurance market, an insurer could not do this type of broad risk averaging because another insurer would come into the market and offer less-than-average rates for consumers with less-than-average risk. The insurer offering only the broadly-averaged rate would suffer "adverse selection," meaning that it would end with above-average risks (as the below-average risk move to the other insurers) while charging the average rate. With HR2091, this is what would occur to the NFIP as surplus lines insurers identify the below-average risks and charge less than the NFIP.

The NFIP premium charge to policyholders includes a policy fee to pay for, among other things, flood mapping activities – activities essential for flood loss mitigation efforts. Reducing the number of NFIP policyholders will result in either fewer funds for these activities, a higher policy fee for the remaining policyholders or both.

In response to Congressional requirements, there is another component beside the policy fee in the NFIP premium which a surplus lines insurer would not need to include in its flood premium – the amounts included for the NFIP reserve and to pay back the loan from the Treasury Department for past NFIP claims. As with the funding for mapping, a reduction in the number of NFIP policyholders means that the amounts collected for NFIP reserves and loan repayment are reduced, the reserve assessment (and NFIP premium) must increase, or both.

As the above discussion makes clear, HR 2091 allows surplus lines insurers to cherry-pick the least risky NFIP policyholders resulting in adverse selection for the NFIP. As the NFIP policyholder base shrinks, the funding for flood mapping, reserves and loan repayment will also shrink. Even if the NFIP attempts to increase the policy fee and reserve amount to cover the shrinking base, then more policyholders will find cheaper policies from private insurers – with the result that the NFIP will be far more financially vulnerable as premium reductions far outpace risk/exposure reduction. This is known as the death spiral.

The proposal set out in my testimony – to require flood be covered as part of the standard residential and commercial property insurance policies with the NFIP moving out of the business of direct provision of flood insurance and into the role of catastrophe reinsurer – is the only meaningful way to move flood insurance to the private sector under state-based regulatory oversight without saddling the federal government – and eventually taxpayers – with endless flood insurance costs.

State Insurance Commissioners' Consumer Protection Authority and Ability to Protect Consumers Purchasing Surplus Lines Insurance is Very Limited

The NAIC testified that state insurance regulators have authority to protect consumers who purchase surplus lines products. However, that authority is very limited and will likely result in consumer complaints with surplus lines flood insurance. Insurance commissioners' authority with surplus lines insurance consists largely of:

- Accepting a surplus lines insurer as eligible in the state. The attached recent bulletin from the Alaska Division of Insurance illustrates this authority. Insurance department oversight of the financial condition of surplus lines insurers is different and less thorough than the financial oversight of admitted insurers.

- Licensing surplus lines agents who issue the surplus lines policies for surplus lines insurers.

- Establishing and enforcing due diligence requirements to ensure surplus lines policies are not issued for types and lines of insurance available from admitted insurers.

Insurance regulators lack authority over surplus lines insurance in several key areas.

- No review and approval of policy forms. For example, state regulator would approve a mandatory arbitration provision and ban on class arbitrations in a homeowners insurance policy. Yet, a surplus lines insurer could not only include such claim settlement requirements in a surplus lines policy, the surplus lines insurer could specify the arbitration take place in the home jurisdiction of the surplus lines insurer – which may be Bermuda or the United Kingdom. The NAIC testified that state insurance regulators have authority to enforce unfair claim settlement practice and unfair and deceptive trade practice laws committed by surplus lines agents and insurers. But it is unclear what authority the NAIC was referring to in this regard if, for example, the surplus lines policy form – over which the insurance commission has no authority – contains unfair or deceptive provisions.

- No review and approval of rates. About seventeen states and District of Columbia have recently issued bulletins advising insurers that "price optimization" is not permitted in establishing rates and premium charges for auto and homeowners. Price optimization refers to a practice of using non-risk related factors – such as a consumer's willingness to accept a higher rate – to set the premium charge. Price optimization violates state law requirements that rates be cost-based and not unfairly discriminatory. Insurance regulators have no authority to stop this or other abusive rating practices on surplus lines policies.

- No guaranty fund protection. Surplus lines insurers do not participate in state guaranty funds, which are organizations created to pay claims in the event the insurer becomes insolvent and is unable to pay the claims on its policies. Mr. Kelley testified that it is impractical for surplus lines agents to participate in state guaranty funds. This "impracticality" may be because surplus lines insurance was intended to address unique coverages, generally for commercial – not personal – insurance. The issue of whether surplus lines insurers should or should not participate in state guaranty funds is irrelevant – the fact remains that surplus lines insurers do not participate in state guaranty funds, with the result that there is no policyholder protection in the event the surplus lines insurer is unable to pay its claims. Mr. Kelley also testified that surplus lines insurers were financially strong and rarely failed. The same is true for admitted insurers – they are financially strong and rarely fail. But the purpose of a guaranty fund is to protect the consumer for that rare event.

In summary, state insurance commissioners lack most of the authority they have to protect consumers purchasing policies from admitted carrier for consumers purchasing policies from surplus lines insurers.

Thank you again for the opportunity to testify on these important flood insurance issues.

Birny Birnbaum

Birny Birnbaum
Executive Director

The Council of Insurance Agents & Brokers
701 Pennsylvania Ave NW Suite 750
Washington DC 20004-2608
Main 202 783 4400 Fax 202 783 4410

July 16, 2015

The Honorable Dean Heller
The United States Senate
Washington, D.C. 20510

The Honorable Jon Tester
The United States Senate
Washington, D.C. 20510

Dear Senators Heller and Tester,

The Council of Insurance Agents and Brokers (The Council) is proud to support S.1679, the *Flood Insurance Market Parity and Modernization Act of 2015,* and thanks you for your leadership on this important issue. Your efforts seek to ensure that consumers have access to private flood insurance options.

The Council of Insurance Agents and Brokers represent the country's largest commercial insurance brokerage firms which collectively produce 90% of the commercial insurance policies in the United States. Council members represent the interests of commercial flood insurance buyers and strongly support a competitive market that provides suitable and affordable coverage options for their corporate clients.

The *Flood Insurance Market Parity and Modernization Act of 2015* amends the definition of private flood insurance to ensure surplus lines insurers are eligible to offer private market solutions and alternatives to consumers in need of unique and complex flood risks. Although surplus lines insurance companies are currently allowed to provide private flood insurance, the definition of private flood insurance should be revised to remove any uncertainty that surplus lines insurance companies are eligible to provide insurance in the insured's home state, in accordance with the *Nonadmitted and Reinsurance Reform Act of 2010,* and to ensure policyholders access to the surplus lines market alternatives.

Thank you for your leadership on preserving a strong, national market for flood insurance options. The Council strongly supports S.1679.

Best,

Ken Crerar
President and CEO

Joel Wood
Senior Vice President
Government Affairs

Joel Kopperud
Vice President
Government Affairs

July 27, 2015

The Honorable Dean Heller
United States Senate
Washington, D.C. 20510

The Honorable Jon Tester
United States Senate
Washington, D.C. 20510

The Honorable Dennis Ross
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick Murphy
U.S. House of Representatives
Washington, D.C. 20515

Re: FSR Supports the Flood Insurance Market Parity and Modernization Act

I am writing on behalf of The Financial Services Roundtable in support of the Flood Insurance Market Parity and Modernization Act, S. 1679, as introduced in the Senate by Sens. Dean Heller (R-NV) and Jon Tester (D-MT), and H.R. 2901, as introduced in the House by Reps. Dennis Ross (R-FL) and Patrick Murphy (D-FL). The legislation clarifies the definition of an acceptable private flood insurance policy in order to increase the availability of flood policies for American homes and businesses and encourage competition in the flood insurance marketplace.

Flooding impacts homeowners and businesses across the country, all too often leaving those impacted struggling to protect themselves and recover following flood events. Affordable flood insurance is the best defense Americans have to combat this risk. The bipartisan, bicameral Flood Insurance Market Parity and Modernization Act encourages privatization of flood insurance by enabling lenders to accept flood insurance policies outside of the National Flood Insurance Program, as long as those policies meet certain coverage requirements. This increases competition and enhances consumer choice.

We at the Financial Services Roundtable look forward to working with the authors of this legislation and other Members of Congress to support enactment of this law and to make broader reforms to the National Flood Insurance Program that will induce significant private sector participation that protects both policyholders and taxpayers.

Sincerely,

Francis Creighton

Francis Creighton
Executive Vice President of Government Affairs

FINANCIAL SERVICES ROUNDTABLE
600 13th Street, NW, Suite 400, Washington, D.C. 20005 | 202-289-4322 | info@FSRoundtable.org | www.FSRoundtable.org

June 30, 2015

The Honorable Dean Heller
United States Senate
324 Hart Senate Office Building
Washington, DC 20510

The Honorable Jon Tester
United States Senate
311 Hart Senate Office Building
Washington, DC 20510

Dear Senators Heller and Tester:

The Mortgage Bankers Association (MBA)[1] wishes to express support for S. 1679, the *Flood Insurance Market Parity and Modernization Act*. Your legislation addresses two of the primary impediments to the development of a private flood insurance market: lack of clarity as to what constitutes acceptable private flood insurance and uncertainty about the effect of private insurance on the continuous coverage requirement.

While the intent of the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12) was for private flood insurance to satisfy the mandatory purchase requirement, lack of clarity in the statutory language had the unintended effect of making it more difficult for lenders to accept private flood insurance policies. Prior to the enactment of BW-12, lenders were permitted to accept private flood insurance to meet the mandatory purchase requirement of the National Flood Insurance Reform Act of 1994.

The Federal Emergency Management Agency (FEMA) published guidance with criteria to assist lenders in deciding whether to accept a private flood insurance policy, though lenders still had the discretion to accept a policy that did not meet the FEMA criteria if they were satisfied that the policy adequately covered the collateral. BW-12 incorporated the FEMA criteria into the definition of private flood insurance and required that private policies be "at least as broad as" a National Flood Insurance Program (NFIP) policy in order for a lender to accept it. The BW-12 requirements have made it difficult for lenders to determine whether a private policy provides the necessary coverage under the definition. With the risk of federal liability for accepting anything less

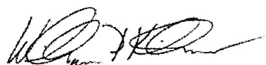
[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org.

than an NFIP policy, lenders have (to date) been reluctant to accept private policies. By allowing individual states to determine what constitutes acceptable private coverage, S. 1679 would add clarity to the current uncertainty amongst lenders in this regard.

In addition, your legislation clarifies that continuous coverage by private flood insurance satisfies any statutory, regulatory, or administrative continuous coverage requirements. Under the current NFIP rules, a policyholder would likely lose any subsidy or "grandfathered" status if they left the NFIP and opted to obtain coverage with a private flood insurance policy. This has created a disincentive for consumers to choose a private policy in lieu of the NFIP and thwarts congressional intent to encourage the development of a more robust private flood insurance market. By clarifying that private coverage satisfies the continuous coverage requirement, S. 1679 will help to make these policies a more viable option for consumers.

In sum, MBA supports S. 1679 as a simple way to effectuate congressional intent and encourage the growth of a competitive and sustainable private flood insurance market. Increased private sector involvement will expand available insurance options, lower costs to consumers, and reduce the federal government's exposure to flood loss over time.

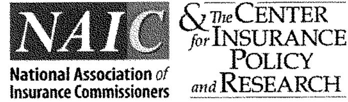
Sincerely,



William P. Killmer
Senior Vice President, Legislative and Political Affairs

cc: The Honorable Richard Shelby, Chairman, Senate Committee on Banking, Housing, and Urban Affairs

The Honorable Sherrod Brown, Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs



July 29, 2015

The Honorable Dean Heller
U. S. Senate
324 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Jon Tester
U. S. Senate
311 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Dennis Ross
U.S. House of Representatives
229 Cannon House Office Building
Washington, D.C. 20515

The Honorable Patrick Murphy
U.S. House of Representatives
211 Cannon House Office Building
Washington, D.C. 20515

Re: Flood Insurance Market Parity and Modernization Act (S. 1679/H.R. 2901)

Dear Senator Heller, Senator Tester, Representative Ross, and Representative Murphy:

On behalf of the National Association of Insurance Commissioners (NAIC)[1], we write to express our support for the "Flood Insurance Market Parity and Modernization Act (S. 1679/H.R. 2901)" to help facilitate the development of a private insurance market for flood insurance.

While the Biggert-Waters Flood Insurance Reform Act of 2012 affirmed Congress's intent that lenders can accept private flood insurance as an alternative to the National Flood Insurance Program, the definition and prescriptive conditions have created a significant obstacle impeding the development of a private market. At this time, the private flood market remains relatively small, but the clarifications included in this legislation will assist in removing any unintended barriers to help prompt more insurers to enter this market if they are willing. Facilitating the entry of additional carriers into the market will provide consumers with access to additional options for flood insurance products, and already we have seen some examples where a private carrier is willing to offer comparable coverage at a lower cost than the NFIP. Over time, this additional competition and shift of risk from a federal program to the private market could help lessen the exposure of U.S. taxpayers to the types of catastrophic flood losses that now reside as unpaid debt on the NFIP's books.

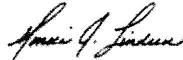
As the private flood insurance market develops, it is important to clarify that state insurance regulators have the same authority and discretion to regulate private flood insurance as they have to evaluate other similar insurance products. States, after all, have over 140 years of experience supervising the business of insurance, protecting policyholders, and balancing affordability with solvency.

[1] Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

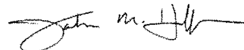
EXECUTIVE OFFICE • 444 North Capitol Street NW, Suite 700 • Washington, DC 20001-1509 p | 202 471 3990 f | 816 460 7493
CENTRAL OFFICE • 1100 Walnut Street, Suite 1500 • Kansas City, MO 64106-2197 p | 816 842 3600 f | 816 783 8175
CAPITAL MARKETS & INVESTMENT ANALYSIS OFFICE • One New York Plaza, Suite 4210 • New York, NY 10004 p | 212 398 9000 f | 212 382 4207
www.naic.org

We commend you for introducing this legislation to help encourage greater growth in the private flood insurance market, provide consumers with additional choices for flood insurance products, and make clear that the state insurance regulatory authorities that have long protected policyholders and allowed for the growth of a vibrant insurance market will apply to private flood insurance. We urge Congress to support this important effort and look forward to continuing to work with you as you move forward with this legislation.

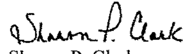
Sincerely,



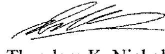
Monica J. Lindeen
NAIC President
Montana Commissioner of
Securities and Insurance



John M. Huff
NAIC President-Elect
Director of Missouri's Department of Insurance,
Financial Institutions, and Professional Registration



Sharon P. Clark
NAIC Vice President
Kentucky Insurance Commissioner



Theodore K. Nickel
NAIC Secretary-Treasurer
Wisconsin Insurance Commissioner

The Honorable E. Benjamin Nelson
NAIC Chief Executive Officer
United States Senator (Ret.)

NAMIC®

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

July 20, 2015

The Honorable Dean Heller
United States Senate
324 Hart Senate Office Building
Washington, DC 20510

The Honorable Jon Tester
United States Senate
311 Hart Senate Office Building
Washington, DC 20510

The Honorable Dennis Ross
United States House of Representatives
229 Cannon House Office Building
Washington, DC 20515

The Honorable Patrick Murphy
United States House of Representatives
211 Cannon House Office Building
Washington, Dc 20515

Dear Senators and Congressmen:

The National Association of Mutual Insurance Companies (NAMIC) writes in support of S. 1679 and H.R. 2901, the Flood Insurance Market Parity and Modernization Act of 2015. This bi-partisan and bicameral legislation addresses an important provision of the Biggert-Waters Flood Insurance Reform Act of 2012, the acceptance of private sector flood insurance policies for homeowners that fall under the mandatory purchase requirement of the National Flood Insurance Program (NFIP).

NAMIC supported the Biggert-Waters Flood Insurance Reform Act of 2012 as it passed with the recognition by Congress that the NFIP must charge actuarial risk based rates in order for the program to become financially solvent. Actuarial risk based rates are a necessary requirement for any insurer to consider underwriting a peril, whether related to natural catastrophes or otherwise. The NFIP's subsidized rates were a key barrier to the availability of private sector coverage for flood insurance, except in the case of additional coverage above the NFIP's coverage limits. With the implementation of actuarial risk based rates, outside of grandfathered properties, insurers have begun to offer private sector flood insurance policies and more considering entering the marketplace. State legislatures such as Florida and Massachusetts have recently addressed the increased interest by the private sector to underwrite flood insurance by passing laws aimed to encourage further development.

S. 1679 and H.R. 2901 makes important clarifications that will help foster development in the private marketplace by defining acceptable private sector flood insurance policies that would meet the NFIP's mandatory purchase requirement. The legislation provides clarifies that a private sector flood insurance policy is one issued by an insurance company that is licensed, admitted, or otherwise approved to engage in the business of insurance in the State by the appropriate state insurance regulator of that state, is eligible as a non-admitted insurer in that state, or issued by and insurance company that is not otherwise disapproved as a surplus lines insurer by that state. The legislation also defines that private sector flood insurance comply with applicable states laws and regulations.

S. 1679 and H.R. 2901 would also allow a property owner to purchase private sector flood insurance coverage equal to the outstanding principal balance of the owner's property to meet the mandatory purchase requirement. This change could provide an incentive for innovative flood insurance products for property owners willing to risk only insuring the remainder of their outstanding loan. It could also foster development of private sector options for property owners that do not fall under the mandatory purchase requirement and would like varying levels of flood insurance coverage. While we believe it is a consumer's choice as to the level of insurance they

feel is adequate for them, we also strongly believe consumers should insure themselves fully against flood risks posed to them so as to avoid financial hardship when a natural catastrophe occurs.

NAMIC thanks you for the introduction of S. 1679 and H.R. 2901, the Flood Insurance Market Parity and Modernization Act of 2015.

Sincerely,

Jimi Grande
Senior Vice President - Federal and Political Affairs
National Association of Mutual Insurance Companies

National Association of Professional Surplus Lines Offices, Ltd.

4131 N. Mulberry Dr., Ste. 200
Kansas City, MO 64116
816.741.3910
F 816.741.5409

The Honorable Dean Heller
U.S. Senate
324 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Jon Tester
U.S. Senate
311 Hart Senate Office Building
Washington, D.C. 20510

Dear Senators Heller and Tester:

On behalf of its membership, the National Association of Professional Surplus Lines Offices (NAPSLO) is pleased to support S. 1679, the *Flood Insurance Market Parity and Modernization Act of 2015*. NAPSLO appreciates your continued leadership and efforts to ensure that consumers have access to private flood insurance options.

NAPSLO is the national trade association representing the surplus lines industry and the wholesale insurance distribution system. NAPSLO's membership consists of approximately 400 brokerage member firms, 100 company member firms and 200 associate member firms, all of whom operate over 1,500 offices representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals in the 50 states and the District of Columbia.

The *Flood Insurance Market Parity and Modernization Act of 2015* amends the definition of private flood insurance to ensure surplus lines insurers are eligible to offer private market solutions and alternatives to consumers in need of unique and complex flood risks. Although surplus lines insurance companies are currently allowed to provide private flood insurance, the definition of private flood insurance should be revised to remove any uncertainty that surplus lines insurance companies are eligible to provide insurance in the insured's home state, in accordance with the *Nonadmitted and Reinsurance Reform Act of 2010*, and to ensure policyholders access to the surplus lines market alternatives.

Often called the "safety valve" of the insurance industry, surplus lines insurers (or nonadmitted insurers) fill the need for coverage in the marketplace by insuring those risks that are declined by the standard underwriting and pricing processes of standard/admitted insurance carriers. In this way, NAPSLO does not anticipate expansion in the surplus lines market, except to the extent the demand for flood insurance exceed that available from the NFIP or standard market. By ensuring the surplus lines industry can continue to participate in this fashion, your legislation ensures that consumers have private options available to them, should they need it.

NAPSLO again thanks and congratulates you on the introduction of common-sense legislation that helps preserve consumers' access to private flood insurance solutions.

Chris Polychron, CIPS, CRS, GRI
2015 President

Dale A. Stinton
Chief Executive Officer

GOVERNMENT AFFAIRS DIVISION
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Scott Reiter, Vice President
Jamie Gregory, Deputy Chief Lobbyist

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Ph. 202-383-1194 Fax 202-383-7580
www.REALTOR.org

July 20, 2015

The Honorable Dean Heller
United States Senate
324 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Jon Tester
U.S. Senate
311 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Dennis Ross
United States House of Representatives
229 Cannon House Office Building
Washington, D.C. 20515

The Honorable Patrick Murphy
United States House of Representatives
211 Cannon House Office Building
Washington, D.C. 20515

Dear Senators and Representatives:

On behalf of over 1 million members of the National Association of REALTORS® (NAR), thank you for introducing the Flood Insurance Market Parity and Modernization Act of 2015 (S. 1679/HR 2901). We support this legislation as a solid first step in the development of private market options where property owners lack access to affordable coverage under the National Flood Insurance Program (NFIP).

Of particular note, S. 1679/HR 2901 would clarify that private flood insurance as well as NFIP coverage satisfies the federal requirement to maintain a minimum amount of flood insurance for the full life of a federally related mortgage in the 100-year floodplain. NAR strongly supports this "continuous coverage" provision. This would prevent the NFIP from hiking rates, removing the disincentive should consumers wish to flood insure in the private market. It also protects consumers by preserving the NFIP as a viable option and keeping them from becoming stranded, should private insurers decide to raise rates or drop coverage after major floods.

These bills would also remove the federal requirement that non-NFIP policies offer the same or better coverage than the NFIP. We don't see the need for an additional layer of federal oversight and red tape for the state licensed or admitted insurance companies since their coverage terms and insurance rates are already strictly regulated. The state is in the best position to protect these insurance consumers. However, it is unclear whether and to what extent states would have the authority to enforce minimum flood insurance coverage requirements in the non-admitted or "surplus lines" market. We also note that the lender disclosure requirements have been removed as well as provisions allowing federal mortgage programs (Fannie Mae, Freddie Mac, FHA, etc.) and the financial regulators (FDIC, Federal Reserve, etc.) to set financial solvency and claims-paying conditions for private flood insurance companies covering federally related mortgages.

Again, we support S. 1679/HR 2901 and we look forward to working with you to enhance some of the bill's provisions and generate congressional support as the bill moves through the legislative process.

Sincerely,

Chris Polychron
2015 President, National Association of REALTORS®

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

January 13, 2016

The Honorable Blaine Luetkemeyer
Chairman
Subcommittee on Housing and Insurance
House Financial Services Committee
2440 Rayburn House Office Building
Washington, DC 20515

The Honorable Emanuel Cleaver II
Ranking Member
Subcommittee on Housing and Insurance
House Financial Services Committee
2335 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Luetkemeyer and Ranking Member Cleaver:

The National Multifamily Housing Council (NMHC) and National Apartment Association (NAA) applaud the Subcommittee for calling a hearing on "How to Create a More Robust and Private Flood Insurance Marketplace." We appreciate your efforts to explore ways to expand access to flood insurance coverage beyond the National Flood Insurance Program (NFIP) in an attempt to reduce taxpayer liability and provide affordable coverage options to property owners where none currently exist.

For more than 20 years, NMHC and NAA have partnered in a joint legislative program to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of nearly 170 state and local affiliates, NAA is comprised of over 69,000 members representing more than 8.1 million apartment homes throughout the United States and Canada.

The NFIP has approximately 5.3 million policies in almost 22,000 communities across the country. The program provides an insurance market alternative to disaster relief funded continually by taxpayers. The NFIP ensures that affordable flood insurance is available at all times, in all market conditions for every at-risk rental property. These include more than just high rise multifamily properties in urban centers along the East and West coasts of our country but extend across every state to include low-rise structures and even single family rental homes. Ensuring that all types of rental property continue to have access to affordable, quality flood insurance through the NFIP is a top priority for our membership to not only protect their property investment but to help manage the increasing costs of providing housing.

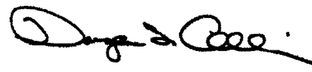
While we strongly support the continued role of the NFIP, our industry acknowledges that the program does not come without its challenges and we agree that further reforms are necessary to protect the long-term financial viability of the program. Therefore, we support the Subcommittees work to foster a more robust private flood insurance marketplace that could lessen the fiscal pressure on the NFIP. Further, NMHC/NAA applauds the efforts of Representatives Dennis Ross and Patrick Murphy in introducing H.R. 2901, the Flood Insurance Market Parity and Modernization Act. This critical piece of legislation would expand coverage options for at-risk property owners by clarifying that flood insurance offered by private carriers outside of the NFIP meets the mandatory purchase requirements in place today. Of particular note is the bill's language that ensures both private and NFIP coverage satisfies the federal government's requirement of "continuous coverage" and protects policyholders from seeing rate hikes should they wish to return to the NFIP coverage at a later date. We support the bill as introduced and appreciate the continued bipartisan work being done to strengthen the legislation

even further. NMHC/NAA support increasing property owner's access to alternative options of coverage outside of the NFIP as a way to increase market competition and make coverage more affordable for multifamily firms across the nation.

We thank you for the opportunity to present the views of the multifamily industry as you look to expand consumer access to affordable flood insurance coverage and work towards reauthorizing and reforming the NFIP. The NFIP serves an important purpose and is a valued and necessary risk management tool for apartment owners and managers. We believe the private sector can share in that role to a larger degree and we stand ready to support the efforts of Congress to make that happen while ensuring the long-term viability of the NFIP.

Sincerely,

Douglas M. Bibby
President
National Multifamily Housing Council



Douglas S. Culkin, CAE
President & CEO
National Apartment Association

cc: Members of the House Financial Services Committee

July 7, 2015

Senator Dean Heller United States Senate Washington, D.C. 20510	Senator Jon Tester United States Senate Washington, D.C. 20510
Congressman Dennis Ross U.S. House of Representatives Washington, D.C. 20515	Congressman Patrick Murphy U.S. House of Representatives Washington, D.C. 20515

Dear Senators Heller and Tester and Representatives Ross and Murphy:

On behalf of the National Association of Professional Insurance Agents (PIA National), we thank you for introducing the Flood Insurance Market Parity and Modernization Act of 2015 (S. 1679/ H.R. 2901). PIA represents independent insurance agents in all 50 states, Puerto Rico and the District of Columbia. While PIA National opposes outright, immediate privatization of the National Flood Insurance Program (NFIP) without a viable structure, we support sensible solutions for growing the private flood insurance market.

PIA members are insurance professionals that provide personal support, advice, and counsel to their customers. Currently, there has been a pervasive rejection of private primary flood insurance by lenders due to the fact that they are unsure of the validity of privately issued flood insurance. That is why it is critical that agents, lenders, and consumers have a simple and clear definition of what is acceptable private flood insurance. This legislation provides a solution by defining private flood insurance as a policy that provides flood insurance coverage issued by an insurance company that is licensed and approved by the state insurance regulator to engage in the business of insurance in the state in which the insured building is located. It also includes a critical provision to ensure that private flood insurance can be used to satisfy the NFIP's continuous coverage requirements.

PIA National greatly appreciates your continued dedication to this issue and your strong advocacy for the role of agents and brokers in the flood insurance market. We look forward to continue working with you on this matter. If PIA National can be of any additional assistance, please contact Jon Gentile, PIA National director of federal affairs, at jonge@pianet.org.

Sincerely,

Mike Becker
Executive Vice President and CEO
PIA National

REINSURANCE ASSOCIATION OF AMERICA

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Washington, D.C. 20005
www.reinsurance.org

FOR IMMEDIATE RELEASE
June 30, 2015

FOR FURTHER INFORMATION
Barb Carroll, RAA
202.783.8390

RAA SUPPORTS LEGISLATION TO INCREASE PRIVATE FLOOD INSURANCE OPTIONS

WASHINGTON, D.C. – Senators Dean Heller (R-NV) and Jon Tester (D-MT) have reintroduced the Flood Insurance Market Parity and Modernization Act, legislation that will provide Americans with more access to high-quality flood insurance coverage. In introducing the legislation, Senator Heller commented, "For many property owners in America, having access to quality flood insurance is critical. Many Americans could have access to more flood insurance coverage options through the private market if Congress acts. Our legislation will open those doors." Heller went on to say, "The legislation Senator Tester and I introduced today provides a clear definition of what is acceptable private flood insurance as determined by state insurance commissioners in order to provide more options. I have always said providing more choices jumpstarts competition, reduces costs for consumers, and increases quality. The same is true when it comes to flood insurance."

Concurrently, Representatives Dennis Ross (R-FL) and Patrick Murphy (D-FL) introduced The Flood Insurance Market Parity and Modernization Act in the House. Rep. Ross commented, "More choices can mean better coverage and cheaper policies for homeowners. This is especially beneficial to Floridians now that we are officially in hurricane season."

Frank Nutter, president of the Reinsurance Association of America, commended the introduction of the legislation in both chambers, noting "Reinsurers have an appetite to underwrite flood risk and this legislation will facilitate the development of a private insurance market for flood risk. We applaud Sens. Tester and Heller and Reps. Ross and Murphy for introducing this legislation, which will provide homeowners with more options, and, importantly, reduce taxpayer liability from the federal government's role in providing flood insurance through the National Flood Insurance Program."

The Reinsurance Association of America is the leading trade association of property and casualty reinsurers doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. The RAA represents its members before state, federal and international bodies.

[End]

SMARTERSAFER.org

July 21, 2015

The Honorable Dennis Ross
229 Cannon House Office Building
Washington, D.C. 20515

Dear Representative Ross:

SmarterSafer-- a broad based coalition of taxpayer advocates, environmental groups, insurance interests, housing organizations, and mitigation advocates-- applauds your efforts to ensure that consumers can purchase flood insurance in the private market if they choose. For many years, the federal government has been the primary provider of flood coverage in the United States. The National Flood Insurance Program (NFIP) has provided critical coverage, but because of deep subsidies embedded in the program for decades, it has done so at great expense to taxpayers, it has harmed the environment, and it has provided the wrong market signals, actually encouraging people to build in harm's way.

To combat these problems, Congress made changes to rates for certain properties, slowly phasing in risk-based rates for a segment of policies and allowing private flood coverage in addition to other reforms. In Biggert-Waters, Congress made clear that private flood coverage should be permitted, and the Grimm-Waters bill did not change this commitment. Since the passage of flood reform, private insurers have started to consider offering flood policies. SmarterSafer believes this should be encouraged; Consumers should be able to choose private flood policies, potentially with terms and coverage that can be tailored to the interests of the consumer, as well as better incentives for mitigation and resiliency. In fact, private flood policies could allow property owners to purchase enough coverage to ensure they can rebuild after a storm, not constrained by NFIP limits or by the amount of the mortgage.

The Ross-Murphy and Tester-Heller bills would ensure that private flood insurance counts for purposes of the mandatory purchase requirements. SmarterSafer supports these efforts and will work to see them passed into law. The coalition is appreciative that one of the hallmarks of the US insurance regulatory system is policyholder protection, and we support private flood insurance in that context. We believe that as policies move to the private sector, Congress must look for ways to ensure that communities continue to focus on preparedness and mitigation, a requirement currently part of NFIP and one worthy of further policy action.

We look forward to working with you on this matter.

Sincerely,

SmarterSafer.org

SMARTERSAFER.org

MEMBERS

Environmental Organizations
American Rivers
Center for Climate and Energy Solutions (C2ES)
Ceres
ConservAmerica
Defenders of Wildlife
Natural Resources Defense Council
National Wildlife Federation
Sierra Club

Consumer and Taxpayer Advocates
Coalition to Reduce Spending
R Street
National Taxpayers Union
Taxpayers for Common Sense
Taxpayers Protection Alliance

Insurer Interests
Allianz of America
Association of Bermuda Insurers and Reinsurers
The Chubb Corporation
Liberty Mutual Group
National Association of Mutual Insurance Companies (NAMIC)
National Flood Determination Association
Reinsurance Association of America
SwissRe
USAA

Mitigation Interests
Natural Hazard Mitigation Association
National Fire Protection Association

Housing
National Housing Conference
National Leased Housing Association

ALLIED ORGANIZATIONS
American Consumer Institute
Association of State Floodplain Managers
Center for Clean Air Policy
Friends of the Earth
Institute for Liberty
Property Casualty Insurers Association of America
Union of Concerned Scientists
Zurich