



# To Be or Not to Be...Privatized

A look into some of the movements recently made to facilitate privatization of flood coverage in homeowners insurance.

**T**here has been an ongoing political and insurance industry debate over how to provide more affordable and robust flood coverage, than currently provided by FEMA. As the 2017 FEMA expiration looms near, the question becomes all the more pressing. The scales are beginning to tilt to privatize flood versus keeping the coverage in the NFIP.

Enterprising insurance and reinsurance companies are entering the flood space in a variety of ways, by seeking to capitalize on the perceived deficiencies of the NFIP in a record-soft market. These include:

- Providing bolt-on solutions or pass-throughs;
- Adding flood onto the homeowner's policy;
- Offering stand-alone flood protection.

## Flood bolt-ons facilitating growth

Currently reinsurers are offering various pass-through options to help both insurance and reinsurance companies grow their portfolio. The reinsurance underwriter can leverage their own expertise and provide value to their clients through:

- Strategic Partnership / White Label products;
- Automatic facultative arrangements;
- Other Treaty Reinsurance arrangements.

## Gaining efficiencies by combining wind and flood

One primary niche carrier has already begun offering flood coverage endorsements, therefore eliminating the need for the flood exclusion in the homeowner's policy. The endorsement provides coverage for direct physical

loss by or from flood under a common wind/flood deductible.

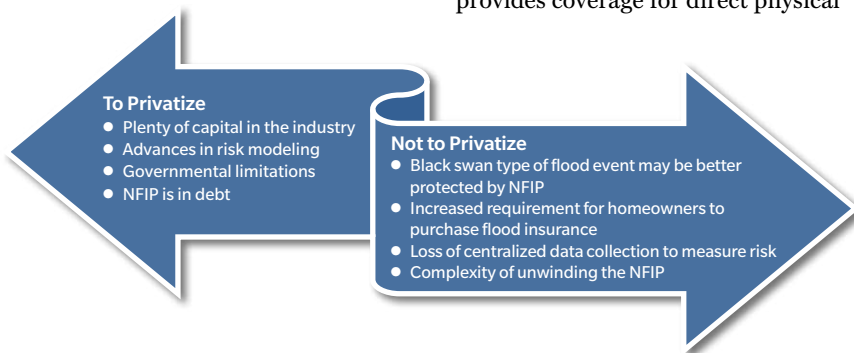
There are several **benefits**:

### Claims leakage

Though flood plain maps are still evolving, protection is straightforward from a riverine flood. On the contrary, for surge-based flooding, insurance companies face the additional cost of identifying and settling wind versus water claims. A combined policy resolves the loss adjustment conundrum by reducing expenses for the insurer and providing clarity to policyholders.

During a hurricane, coastal properties often face a barrage of both strong winds, and an impending surge of water pushed on shore by the storm system. While roof damage and flooded basements are obvious, there is often ambiguity as to whether wind or water caused damage. Because of this uncertainty, a portion of the flood loss may be paid for by the primary policy, which would otherwise be excluded. This "leakage" has insurance and reinsurance companies searching for how to quantify, or price, for inflated losses due to flood.

In support of privatization is the elimination of this claims ambiguity. Companies assess a risk for wind and flood, and are able to price accordingly. Unless there are different limits available for wind versus flood,



the benefits to adjusting these claims are: removal of causation questions and reduction in settlement time, benefiting both for insurers and their reinsurance partners.

#### *Operational savings*

An insurer is able to realize bottom-line operational savings, while simultaneously reducing their agent partners' expenses, who only need to interface with one underwriter and claims adjuster and manage a single policy document / language. Agents also benefit from possible lower E&O exposure by avoiding coverage gaps and having a common inception date.

Despite the noted savings, the one critical cost to this process is the operational addition in both adding to the risk management and enhancing, training, and building changes to the underwriting process. Some of this may be mitigated by a reinsurer bolt-on product, where reinsurers are providing support from both angles.

#### *Flood mapping*

Post event, properties and surrounding structures may have made significant changes that affect the landscape of the flood risk – possibly not reflected in NFIP produced maps. A consumer could lower their rates by petitioning the accuracy of these flood maps. In some cases this could create a gap between

risk potential and premium charge. With a privatized approach, fair market competition may be the better vehicle to reflect the most recent state of affairs and ultimately benefit the consumer.

#### *Getting paid for the exposure*

While LAE costs are managed, exposure from flood does increase for an insurance company. This may result in additional reinsurance protection,

their overall risk to the peril.

That said, the above-mentioned industry and consumer efficiencies are not realized in this scenario. In fact, an additional layer of difficulty will be generated in this approach for the residual markets. In the case where a carrier wants to cede a wind policy to a wind pool or property residual market which would, in turn, require flood insurance from an approved carrier (i.e. NFIP and not the one

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further capital support, and/or additional bolt-on flood products. Despite this increase, insurance companies are explicitly getting paid (should they price it appropriately) for the risk they're taking, rather than suffering claims leakage.

#### *Stand-alone flood protection*

The possibility of offering a stand-alone flood protection is facilitated by industry-wide capital management and bolt-on products / services offered by reinsurers. One key benefit is to have the flood risk robustly underwritten by experts in the field, and who are responsible for managing

listed), there may be two losers: the insurance company for needing to retain the risk and/or the consumer in needing to rewrite their policy for protection.

Flood privatization is clearly on the forefront of the insurance industry's mind with PCI including it in the forefront for the 2017 Agenda. What the final design is could be any combination of the above.

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