

SilverStone Group

RISK MANAGEMENT

Property & Casualty

Wind vs. Water

Waiting for a Solution

by Chuck Eckert



America has held its collective breath as the 2010 hurricane season enters its final, and traditionally most active, months. While we closely watch the weather, hoping to make it safely through a fourth consecutive year without experiencing catastrophic damage caused by a major hurricane, we must also carefully follow Congress as it considers ways to resolve the current wind vs. water damage disputes. With a typical hurricane-related loss, determining how much of the loss is caused by water and how much is due to wind can be difficult, particularly for the insurance adjusters who handle the claims. This issue has gained considerable attention due to the destruction caused by hurricane Katrina. Following the disaster, countless storm victims found themselves in court, trying to prove how much of their home's damage was caused by water and how much was caused by wind. With current weather conditions indicating a dramatic end to the 2010 hurricane season, additional unsuspecting homeowners could potentially find themselves in a similar insurance battle if this problem isn't resolved in an acceptable time frame.

Many frustrated government officials are speaking out on this topic, arguing that homeowners should not have to enter a court room to fight for coverage they have already paid for. In an attempt to reduce conflict, members of Congress have repeatedly deliberated over a bill that would add windstorm coverage to the National Flood Insurance Program (NFIP). The NFIP is a federal program which serves to offer property owners the opportunity to purchase insurance protection against flooding. The program recently received its eighth temporary extension within the last two years with the signing of the NFIP Extension Act of 2010 (H.R. 5569). Although the House of Representatives has opted not to act, at least for the time being, on the proposed bill that would add windstorm coverage to the NFIP, Congress will likely see modified versions of it in the near future as concerns continue to mount and opinions grow even more divided over this issue.

Fading support

It appears the support that initially existed to add windstorm coverage to the NFIP is quickly diminishing. Many House members have developed second thoughts, arguing that it would be a mistake to add a peril to the program that does not belong there. Currently, coverage for wind damage is readily available in the private insurance market, as well as through state wind pools. The Property Casualty Insurers Association of America believes that resistance to the bill is relatively far-reaching, indicating that opponents of the bill include not only insurance industry personnel, but also environmental groups, consumer advocates, taxpayer watchdogs, the business community and the White House.

While initiatives to resolve the wind vs. water disputes have been temporarily paused, government-offered flood insurance recently received some attention when the House passed the Priorities Act of 2010 on July 15, which is structured to extend the NFIP for an additional 5 years.

Taking action now

Senator Roger Wicker of Mississippi recently introduced a bill which seeks to address the disputes over wind vs. water damage following hurricane-driven storm surges. His bill proposes that both the wind insurer and the NFIP each pay the policy holder 50% of a disputed claim before settling differences through arbitration.

Senator Wicker's bill raises 2 areas of significant concern, the first being that there would need to be a sufficient buy-in on the part of the insurance carriers. Second, if disputed claims are to be sent to arbitration panels, these panels would need to be set up by state departments of insurance rather than by the Federal Government. Many members of Congress believe that the bill introduced by Senator Wicker is simply a distraction from the fundamental problems facing the NFIP at this time. Congress must find a way to make the program actuarially sound. This bill would appear to only shift the expense of storm losses, ultimately raising the cost of insurance for consumers. Most in Congress believe that the NFIP must stand on its own, be financially sustainable and ease the exposure to taxpayers over the long term. Senator Wicker's bill will not be considered until at least September 2010.

While initiatives to resolve the wind vs. water disputes have been temporarily paused, government-offered flood insurance recently received some attention when the House passed the Priorities Act of 2010 on July 15, which is structured to extend the NFIP for an additional 5 years. At the time this article went to print, the Senate had not yet voted on the matter. Although the bill, also known as H.R. 5114, continues to exclude wind coverage and provide only flood coverage, it would result in a variety of changes to the current NFIP provisions. Listed on the next page are some of the notable modifications.

- An increase for maximum coverage limits for residences, residential contents and nonresidential properties. Residences would increase from \$250,000 to \$335,000, residential contents would go up from \$100,000 to \$135,000 and nonresidential properties would increase from \$500,000 to \$670,000.
- Coverage would be established for additional living expenses and costs relating to business interruption. Additional living expenses coverage would carry a minimum of \$1,000, while business interruption coverage would be arranged by the FEMA Administrator in an approach that was consistent with the NFIP's current underwriting capabilities.
- A flood insurance premium payment installment plan would be made available to low-income families.
- The current fine for federally-regulated lending institutions who fail to enforce mandatory flood insurance purchase requirements would be increased to \$2,000, while the cap on fines for institutions would go up to \$1 million.
- A 5-year postponement period would be instituted for the mandatory flood insurance purchase requirement for newly designated Special Flood Hazard Areas identified after September 1, 2008.
- Full-risk rates would be phased in for areas newly classified as Special Flood Hazard Areas. The rate phase would be 20% per year for 5 years, beginning after the mandatory flood insurance purchase requirement delay. The bill would also raise the annual limit on premium increases from 10% to 20%.
- Minimum annual deductibles would be increased for both pre-FIRM properties (buildings constructed before the effective date of a community's initial Flood Insurance Rate Map) and post-FIRM properties (buildings constructed after the effective date of a community's initial Flood Insurance Rate Map). Pre-FIRM property deductibles would increase to \$1,500 for claims under \$100,000 and \$2,000 for claims over \$100,000. Post-FIRM property deductibles would increase to \$750 for claims under \$100,000 and \$1,000 for claims over \$100,000.
- FEMA would have to begin enforcing landlords to notify tenants when their property is located in a flood zone. Landlords would also be required to provide tenants with information on flood insurance coverage and the different means of purchasing that coverage.
- Actuarial rates would begin to replace the use of subsidized rates for commercial and non-primary

residential pre-FIRM properties (e.g., vacation homes). The actuarial rates would also apply to pre-FIRM single principal residences sold after the passage of this proposed bill. The new use of actuarial rates would not apply to multifamily rental properties or rentals that serve as the primary residence for a tenant.

On July 19, 2010, the proposed legislation was read to the Senate and was then referred to the Senate Committee on Banking, Housing and Urban Affairs. If the Senate should fail to act on it, the current NFIP extension will lapse after September 30, 2010. Should this lapse occur, homeowners will not be able to purchase new flood insurance or renew policies currently in place. This could create monumental problems for the real estate market, as many lenders require flood insurance to back up home mortgages. If buyers are unable to obtain a flood insurance policy for their home, they will not be able to close on their mortgage.

The future of NFIP

It has been 5 years since Hurricane Katrina devastated the Gulf region and, due to political infighting, we have yet to see meaningful NFIP reform. Congress has relied on short-term extensions that have created unacceptable lapses in coverage in the NFIP for the past several months. As another NFIP expiration date draws near, Congress faces pressure from consumers and the insurance industry to take action. They have maintained a reckless pattern of short-term extensions that could have overwhelming consequences should another serious natural disaster occur.

September 2010 is expected to usher in more progress on the wind vs. water controversy. In addition to NFIP reform bills, Congress could potentially see a variety of proposed legislation, ranging from the establishment of a national catastrophe insurance fund (referred to as the "Beach House Bailout" bill by critics), to government-sold windstorm coverage. At the present time, these proposals have minimal support, but they could become possible solutions if a major storm was to hit the United States and the government needed to respond.

As Congress reconvenes and begins to address the arguments surrounding the wind vs. water controversy yet again, SilverStone Group will closely follow the latest developments and keep you informed of any decisions as they become available.

Information for this article was accessed at <http://www.property-casualty.com>, Gusman, Phil and Arthur Postal, "Wind vs. Water Dispute Resolution Sought in Latest Flood Insurance Bills" National Underwriter, August 9, 2010, on September 2, 2010.