

January 6, 2017

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Re: Loans in Areas Having Special Flood Hazards—Private Flood Insurance; Docket ID OCC-2016-0005;  
Docket No. R-1549; RIN 3133-AE64

Dear Sirs:

On behalf of the National Association of Insurance Commissioners (NAIC)<sup>1</sup>, we write today regarding the joint notice of proposed rulemaking on “Loans in Areas Having Special Flood Hazards—Private Flood Insurance.” State insurance regulators support facilitating increased private sector involvement in the sale of flood insurance as a complement to the National Flood Insurance Program (NFIP) to help provide consumers with additional choices for flood insurance products. Although one of the objectives of the Biggert-Waters Flood Insurance Reform Act of 2012 was to encourage greater private sector participation by requiring lenders to accept private flood insurance, the definition of and regulatory environment surrounding private flood insurance created by the Biggert-Waters Act is at odds with this objective. The NAIC supports legislative efforts in Congress to address concerns with the definition of private flood insurance included in the Biggert-Waters Act.

While the NAIC prefers a legislative solution to encourage acceptance of private flood insurance, we nevertheless appreciate the Agencies’ efforts to develop implementing regulations that try to balance the

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<sup>1</sup> 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.

complexities of legal and regulatory objectives that are not burdensome to lenders, the Agencies, insurers, or state insurance regulators. Set forth below are our views and comments on specific aspects of the proposed rule.

### **Acceptance of Surplus Lines' Personal Lines Private Flood Insurance Policies**

The proposed rule stipulates that nonresidential commercial policies offered by surplus lines insurers can be accepted by lenders, but does not specify if personal lines residential policies offered by surplus lines insurers can be accepted for purposes of satisfying the mandatory purchase requirement.<sup>2</sup> Surplus lines carriers insure unique or otherwise difficult to underwrite risks that the admitted market is, at least initially, reluctant to insure. Given that surplus lines insurers are providing much of the private flood insurance coverage in the market at this time, limiting acceptance to only commercial coverage could impede consumers' access to additional options for residential flood insurance products. Surplus lines carriers' residential policies may be able to offer consumers additional coverage features or greater limits than the NFIP at a more affordable price. Therefore, we request that the Agencies explicitly state that personal surplus lines residential insurance policies offered by surplus lines insurers and brokers can be accepted by lenders.

State insurance regulators have authorities over surplus lines carriers and we see no reason to prohibit banks from accepting such coverage to satisfy the mandatory purchase requirement. Specifically, state insurance regulators oversee the surplus lines insurance marketplace by imposing solvency requirements on eligible U.S.-based carriers and licensing and supervising surplus lines brokers. Surplus lines insurers 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. Importantly, the insurance regulator of the state where the policyholder resides also 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. In the event a policyholder is the victim of misconduct by the broker, the insurance regulator can sanction the broker or revoke their license. If there is a problem with coverage and a claim being paid, whether resulting from acts of the broker or insurer, the insurance regulator can ultimately hold the broker liable for the full amount of the policy. This regime provides strong incentives for surplus lines brokers to not only comply with applicable laws themselves but also to sell policies from surplus lines carriers that are in a strong financial condition and in good standing.

Most state insurance regulators can also use their authorities under the state Unfair Trade Practices Act and similar statutes to ensure consumers are protected, including that claims are paid, the insurer or broker is not misrepresenting what is in the policy, as well as remedying other bad conduct. State insurance regulators have a long history of monitoring the emergence and innovation of new products and coverages, and tailoring regulation over time to ensure consumers are appropriately protected and policies are available. As the private flood insurance market grows and more companies offer coverage, including admitted carriers, state insurance regulation will continue to evolve to meet the size and breadth of the market as well as the needs of consumers.

### **Private Flood Definition**

The proposed rule mandates the acceptance of private flood insurance that is "at least as broad as" the coverage provided under a Standard Flood Insurance Policy (SFIP). The proposed rule also states that "at least as broad" means that the policy, at a minimum, contains the coverage provisions specified in an SFIP, including those relating to building property coverage and personal property coverage, if purchased by the insured mortgagor, and "may not contain conditions that narrow the coverage provided in an SFIP." We have concerns that the

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<sup>2</sup> See Loans in Areas Having Special Flood Hazards-Private Flood Insurance, 81 Fed. Reg. 78,063, 78,073 (proposed Nov. 7, 2016) (to be codified at 12 C.F.R. pt. 22).

proposed rule could be interpreted to allow banks to reject private flood insurance policies that should be accepted under the mandatory acceptance provision when they: 1) do not contain the specific wording and coverage of the SFIP; 2) are otherwise compliant with federal law; and 3) are not appropriately tailored to the consumers' particular needs. As a result, consumers might be forced to pay more for flood insurance coverage than they otherwise should. Consumers should have the choice to purchase a private flood insurance policy that meets their particular coverage and financial needs.

First, the proposed rule could be interpreted to require banks to only accept private flood insurance policies that contain the specific wording and coverage of the SFIP even when such provisions do not fit the property being insured. For example, Section III.A.8 of the SFIP requires coverage for certain items of property in a basement, such as a furnace or a hot water heater. If a property does not have a basement, an admitted or surplus lines insurer should not be required to provide a policy that mirrors the SFIP with respect to property in basements for purposes of satisfying the definition of private flood insurance in the Biggert-Waters Act. We request that the Agencies explicitly acknowledge that a private flood insurance policy **can** be tailored to a specific property and still be accepted by lenders.

Second, the proposed rule could result in banks rejecting policies that are otherwise compliant with federal law. For example, in Section III.A.3 of the SFIP, building property coverage includes coverage for a detached garage. However, federal law specifically exempts detached structures that are not used as residences from the mandatory flood insurance purchase requirement.<sup>3</sup> The proposed rule does not appear to make an accommodation for that exemption, and therefore could be interpreted to require such coverage. We request that the Agencies provide clarifications regarding the treatment of exemptions under federal law, such as the one for detached garages.

Last, the proposed rule could be interpreted to impose prescriptive criteria with regard to the purchase of personal property coverage. Purchasing personal property coverage is not required under federal law unless the personal property is used as security for the loan.<sup>4</sup> Under the proposed rule, if a consumer were to choose to purchase optional personal property coverage, it appears that at a minimum, the coverage would have to match the terms and conditions of such coverage set forth in the SFIP even though the coverage may not suit the needs of the policyholder. We request that in cases where personal property is not secured by the loan, the Agencies allow consumers the flexibility to determine the amount and extent of the optional personal property coverage they wish to purchase rather than match the coverage specified in the SFIP.

### **Multiple Peril Insurance Policies**

It is our understanding that some insurers in the marketplace are adding the flood insurance peril to a homeowners policy, rather than having a stand-alone flood insurance policy. We would encourage the Agencies to make more explicit that multiple peril policies would be acceptable private flood insurance coverage, provided such policies meet the other requirements of the regulation.

### **Definition of Mutual Aid Society**

The proposed rule also includes an exception that would allow lenders to accept private flood insurance policies provided by "mutual aid societies," defined as organizations (1) whose members share a common religious, charitable, educational, or fraternal bond; (2) which cover losses caused by damage caused by flooding pursuant to agreement; and (3) which have a demonstrated history of fulfilling the terms of agreements to cover losses to members caused by flooding.

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<sup>3</sup> 42 U.S.C. § 4012a(c)(3) (2014).

<sup>4</sup> *Id.* § 4012a(b)(1)(A).

We understand that the Agencies are being responsive to legitimate concerns expressed by commenters regarding the acceptance of certain nontraditional coverage that does not meet the statutory definition for private flood insurance, such as Amish Aid plans. The Agencies have requested specific comment on the criteria in the proposed definition and whether any alternative or additional criteria should be included in the final rule. While there are legitimate reasons that certain entities such as mutual aid societies receive exemptions from state insurance laws, we have concerns that your proposed definition may sweep in entities that may be engaging in the business of insurance without a license or lawful exemption from state insurance licensing rules or insurance laws. To that end, we request that the agencies add a fourth requirement to the proposed rule's definition of "mutual aid society" that would require the entity to demonstrate that it meets a specified exemption to a state's insurance code or licensing rules.<sup>5</sup>

We appreciate the opportunity to comment on the proposed rule and look forward to a continued dialogue with the Agencies as you consider further changes to the proposed rule. Should you wish to discuss this comment or any other matter relating to the NAIC's views on this proposed rule, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471-3980 or Mark Sagat, Assistant Director, Financial Policy and Legislation, at (202) 471-3987.

Sincerely,



Ted Nickel  
NAIC President  
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Commissioner of Insurance



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<sup>5</sup> See, e.g., 40 PA. CONS. STAT. ANN. § 365 (West 2016); TEX. INS. CODE ANN. §§ 886.001–.703 (West 2015).