MORTGAGE BANKERS ASSOCIATION

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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

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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

[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.