

HOUSE BILL REPORT

ESHB 2560

As Passed House:
February 12, 2010

Title: An act relating to forming joint underwriting associations.

Brief Description: Forming joint underwriting associations.

Sponsors: House Committee on Financial Institutions & Insurance (originally sponsored by Representatives Orwall, Upthegrove, Quall, Simpson, Nelson and Morrell; by request of Insurance Commissioner).

Brief History:

Committee Activity:

Financial Institutions & Insurance: 1/13/10, 1/28/10 [DPS];
General Government Appropriations: 2/4/10, 2/5/10 [DPS(FII)].

Floor Activity:

Passed House: 2/12/10, 66-30.

Brief Summary of Engrossed Substitute Bill

- Grants the Insurance Commissioner the authority to create a joint underwriting authority for excess flood insurance.
- Grants the Insurance Commissioner the authority to create market assistance plans for property insurance.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 7 members: Representatives Kirby, Chair; Kelley, Vice Chair; Hurst, McCoy, Nelson, Santos and Simpson.

Minority Report: Do not pass. Signed by 4 members: Representatives Bailey, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Roach and Rodne.

Staff: Jon Hedegard (786-7127).

HOUSE COMMITTEE ON GENERAL GOVERNMENT APPROPRIATIONS

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Majority Report: The substitute bill by Committee on Financial Institutions & Insurance be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives Darneille, Chair; Takko, Vice Chair; Blake, Dunshee, Hudgins, Kenney, Pedersen, Sells, Van De Wege and Williams.

Minority Report: Do not pass. Signed by 3 members: Representatives McCune, Ranking Minority Member; Klippert and Short.

Staff: Charlie Gavigan (786-7340).

Background:

Flood Insurance.

In 1968 the federal government created the National Flood Insurance Program (NFIP) to limit flood damage and to provide coverage. According to the NFIP, approximately 32 insurers participate in the NFIP in Washington. There is no state oversight of the NFIP policies. The NFIP policies may be offered by participating insurers and their agents. Agents licensed in Washington who sell federal flood insurance policies are required by state law to comply with the minimum training requirements required by the Federal Emergency Management Agency. Flood insurance is not generally provided by the authorized insurance market. Flood damage is excluded in most private property insurance policies. Flood coverage may be available above the NFIP policy limits, often in the surplus lines markets.

The NFIP policy limits are generally as follows (higher limits of building coverage may be available in Alaska, Hawaii, the U.S. Virgin Islands, and Guam):

Building Coverage.

Single-family dwelling	\$250,000
Other residential	\$250,000
Non-residential	\$500,000

Contents Coverage.

Residential	\$100,000
Non-residential	\$500,000

Market Assistance Plans.

A Market Assistance Plan (MAP) is a voluntary mechanism by insurers writing casualty insurance in this state (in either the admitted or nonadmitted market) to provide casualty insurance for a class of insurance. The bylaws and method of operation of any MAP must be approved by the Insurance Commissioner (Commissioner) prior to its operation. A MAP must have a minimum of 25 insurers willing to insure risks within the designated class of insurance. The Commissioner can compel casualty insurers to participate to fulfill the quota. The Commissioner's requirement is a condition of continuing to do business in this state. The Commissioner's designation must be based on the insurer's premium volume of casualty insurance in this state. Essentially, a MAP does not provide or require coverage. Instead, it is a mechanism intended to allow the potential insured to have their application reviewed by the MAP participants.

Joint Underwriting Authorities.

A Joint Underwriting Authority (JUA) is a statutorily created entity authorized by the Legislature to provide coverage in specific markets where insurance is all but unavailable. A JUA is generally intended to solve issues of availability of insurance, though it may have some impact on affordability also. Once a JUA is authorized, the Commissioner usually has the authority to establish a nonprofit entity that provides insurance coverage to a specified class of prospective insureds. The JUA is comprised of insurers who can be compelled to participate as a condition of continuing to do business in this state. Those insurers are usually licensed to sell that type of product. To help fund the JUA, the Commissioner may impose monetary assessments. The Commissioner usually adopts a plan of operation by rule. That plan may be developed primarily by the Commissioner or the participating insurers. Administration of the JUA may be contracted to a servicing insurer. Rates and forms are usually established by the JUA's member insurers. Those rates and forms are subject to the same standards as are applicable in the market.

There are two statutorily created JUAs in the state;

- the Day Care JUA, established in 1986 but never activated; and
- the Midwives' JUA created in 1993.

The Midwives' JUA.

The JUA providing midwifery and birth center malpractice insurance was activated after a MAP did not resolve market issues. The Midwives' JUA is governed by a board of representatives from member insurers, the service insurer, and other industry licensees. Board members are appointed by the Commissioner. Standards for eligibility for coverage are established by rule. Member insurers are insurers that have a certificate of authority to write medical malpractice, general casualty insurance, or both in Washington. Under state law, all member insurers are liable for the assessment for the startup costs of the JUA. Any ongoing assessment is based on "direct premiums earned" in Washington for "medical malpractice" and for specific "other liability" on the member insurer's most recent annual statement. By rule, member insurers reporting zero "direct premiums earned" in those areas are not assessed.

Summary of Engrossed Substitute Bill:

"Excess flood insurance" is defined as "insurance against loss, including business interruption, arising from flood that is in excess of the limit of liability insurance offered" by the NFIP.

Definitions.

"Dam" is defined as a U.S. Army Corps of Engineers dam in a county with a population over one million people.

"Personal lines" are defined to include:

- private passenger automobile coverage;
- homeowner's coverage and renter's coverage;
- dwelling property coverage;
- earthquake coverage for a residence or personal property;
- personal liability and theft coverage;

- personal inland marine coverage; and
- mechanical breakdown coverage for personal auto or home appliances.

Personal lines are excluded from the definitions of "property insurance," and "casualty insurance."

Market Assistance Plans.

The Commissioner must by rule require insurers authorized to write property insurance in this state to form a MAP to assist persons located in the geographical area protected by any dam that are unable to purchase excess flood or business interruption insurance in an adequate amount from either the admitted or nonadmitted market

The bylaws and method of operation of any MAP must be approved by the Commissioner prior to its operation. A MAP must have a minimum of 25 insurers willing to insure risks within the class designated by the Commissioner. If 25 insurers do not voluntarily agree to participate, the Commissioner may require certain insurers to participate in a MAP as a condition of continuing to do business in this state. This requirement may be imposed on property insurers, casualty insurers, or insurers licensed to sell property and casualty insurance. The Commissioner must make such a requirement to fulfill the quota of at least 25 insurers. The Commissioner must make his or her designation on the basis of the insurer's premium volume of property insurance in this state.

Establishment of a Joint Underwriting Association for Excess Flood Insurance.

The Commissioner may establish a Joint Underwriting Association for Excess Flood Insurance (Flood JUA) to provide excess flood insurance for damages arising from the failure of a dam or from efforts to prevent the failure of a dam. The Commissioner must hold a hearing before forming a Flood JUA. A Flood JUA may not begin underwriting operations until the Commissioner finds that:

- a MAP is inadequate because fewer than four admitted or surplus lines insurers are offering excess flood insurance, exclusive of personal insurance;
- persons, businesses, or service providers cannot buy excess flood insurance through the voluntary market; or
- there are so few insurers selling excess flood insurance that a competitive market does not exist.

A finding by the Commissioner may be appealed. The determination that four or more admitted or surplus lines insurers are offering excess flood insurance, exclusive of personal insurance, is prima facie evidence that a competitive market does exist.

Qualifications to be Insured Under the Flood JUA.

If a Flood JUA is formed, a person that is unable to obtain excess flood insurance because it is unavailable in the voluntary market or because the market is not competitive is eligible to apply to an association for insurance. A Flood JUA may decline to insure persons that present an extraordinary risk because of the nature of their operations, property condition, past claims experience, or inadequate risk management. However, the mere location of the property does not constitute an extraordinary risk. Any denial of coverage must include:

- a statement of the actual reason for declination; and
- a statement that the applicant may appeal the decision to the Commissioner.

If the Commissioner finds that the decision to decline coverage is not supported by the criteria, the Commissioner may require the Flood JUA to provide coverage. A decision of the Commissioner to provide or to decline to provide coverage may be appealed administratively.

Member Insurers.

Every insurer that has a certificate of authority to write either casualty or property insurance, or both, in this state must be a member of the Flood JUA as a condition of its authority to continue to transact business in this state. Surety insurance is excluded from the definitions of "property insurance" and "casualty insurance."

Governing Board.

The governing board (board) must consist of seven persons:

- Three board members must be member insurers appointed by insurance associations. At least one of the insurers must be a domestic insurer.
- Four board members must be residents. They may not be employed by, serve on the board of directors of, or have a substantial ownership interest in any insurer. One is appointed by the Commissioner. One is appointed by the King County Council. One is appointed by the Association of Washington Cities, to represent one or more of the following municipal governments: Auburn, Kent, Renton, or Tukwila. One is appointed by the board of directors of the Center for Advanced Manufacturing Puget Sound.

Original board members must be appointed to serve an initial term of three years and may be appointed for a second term. There is a process for members of the board to be removed by the board. Board members have a fiduciary duty to the policyholders of the Flood JUA.

Board members must not be compensated but may be reimbursed for expenses incurred to attend meetings. Indemnification by the Flood JUA is required for costs and expenses in connection with the defense of any action or suit related to the performance of duties for:

- board members;
- officers or employees of Flood JUA; and
- member insurers.

Indemnification is not available for willful misconduct.

The board may select one or more persons to manage the operations of the Flood JUA. A manager must be authorized to transact insurance in the state and have demonstrated expertise in excess flood insurance.

Plan of Operation.

The board must adopt a Plan of Operation (Plan) within 30 days of its appointment. The Plan may take effect only after review by the Commissioner. The Commissioner may recommend changes. The changes must be approved by the board, or a written explanation of the rejected changes must be provided to the Commissioner. A Plan may be amended. All amendments must be approved by the Commissioner and a majority of the board.

Rates.

The Flood JUA must use rates that comply with chapter 48.19 RCW and that have been approved by the Commissioner. An actuarial analysis must accompany a rate filing.

Coverage Limits.

The flood JUA may offer policies with coverage limits of up to \$5 million. There is an aggregate exposure cap of \$250 million for all in-force. The board and the Commissioner must equitably apportion policies within these limitations.

Unfair Practices.

A Flood JUA must comply with the provisions of the chapter in the Insurance Code that address unfair practices.

Annual Statement and Reporting.

A Flood JUA must file a statement annually with the Commissioner that contains information about the Flood JUA's transactions, financial condition, and operations during the preceding year. The statement must be in the form and in a manner approved by the Commissioner. The Commissioner may require a Flood JUA to furnish additional information.

Examinations.

The Commissioner may examine the transactions, financial condition, and operations of a Flood JUA. A Flood JUA is responsible for the total costs of its examinations.

Taxes and the Liability of the Guaranty Fund.

A Flood JUA is exempt from payment of all fees and all taxes levied by the state or any of its subdivisions, except taxes levied on real or personal property.

A Flood JUA is not a member of the guaranty fund created in the Washington Insurance Guaranty Association Act. The guaranty fund created under chapter 48.32 RCW, the state, and any political subdivisions are not responsible for losses sustained by the Flood JUA.

Funding of a Flood JUA.

A Flood JUA is funded by premiums paid by persons insured by the Flood JUA.

A Flood JUA may assess its members to pay past and future financial obligations of the Flood JUA not funded by premiums. An assessed insurer must pay within 30 days after it receives notice of the assessment. If an insurer does not pay an assessment in a timely manner:

- the assessment accrues interest at the maximum legal rate until it is paid in full. The interest is paid to the Flood JUA;
- the Flood JUA may collect the assessment in a civil action and must be awarded its attorneys' fees if it prevails;
- the Commissioner may suspend, revoke, or refuse to renew an insurer's certificate of authority; and
- the Commissioner may fine the insurer up to \$10,000.

Duration of a Flood JUA.

A Flood JUA may operate for a period of five years. At the end of the five-year period, the Flood JUA must be dissolved unless the Legislature authorizes its continued operation. Prior to the ending of the five-year period, the Commissioner or the board may hold a hearing and determine that:

- excess flood insurance is available in the voluntary market;
- excess flood insurance is available through a MAP; or
- a competitive market exists.

After such a finding, the Commissioner or the board must order the Flood JUA to end its underwriting operations.

Dissolution of a Flood JUA.

If the Commissioner or the board orders a Flood JUA to end all underwriting operations, the Commissioner must supervise the dissolution of the Flood JUA, including settlement of all financial and legal obligations and distribution of any remaining assets.

Rule-making Authority.

The Commissioner may adopt all rules needed to implement and administer this chapter and to ensure the efficient operation of the Flood JUA, including but not limited to rules:

- creating sample Plans;
- requiring or limiting certain policy provisions;
- regarding the basis and method for assessing members of the Flood JUA; and
- establishing the order in which the assets of a dissolved Flood JUA must be distributed.

Report to the Legislature.

The board and the Commissioner must annually report to the Legislature beginning on January 31, 2011, and continuing through the subsequent year after a Flood JUA is dissolved.

Surplus Lines.

A Flood JUA is not a part of the market that must be included in a surplus lines broker's search before the broker may sell surplus lines coverage.

The act expires on December 31, 2016.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately.

Staff Summary of Public Testimony (Financial Institutions & Insurance):

(In support) It may take five to seven years before the Howard Hanson Dam and the area levies in the Green River Valley are repaired. Area businesses are not able to buy adequate insurance. The NFIP policy limits are too low to be useful. Businesses are moving out or not moving into the area due to lack of flood coverage. A MAP would be a good first step but a JUA may be needed. Some say that there is an adequate market. The Office of the

Insurance Commissioner (OIC) did a survey. Only three insurers were found. Some of the coverages being offered are not appropriate for the businesses that need insurance. In the surplus lines market, there is little sign of activity. Surplus lines policies do not have the same kind of oversight as the policies sold in the admitted market. Business interruption coverage is not offered by the NFIP. In 24 states, the insurance commissioner has general authority for a JUA. This is a narrow, focused bill. The bill allows the Commissioner to create a MAP. Often a MAP will help forestall a JUA. Cost is an issue. Premiums will be set like any product. The rate must be justified and relative to the risk. The insurance will not be cheap. If the OIC does not do the job, it can be sued. The possible impacts on the insurance market are unknown. The weather, policy limits, and enrollment of insureds are among the factors that simply are not known today. If there is no flood, there should not be costs to the insurers. If there is a flood, costs will be spread across all property and casualty insurers. A broader authority would be preferable so the Commissioner could move more quickly in the future. This authority would only apply to the Green River Valley. The amendments are useful. It is unlikely that a JUA could be established for this year's rainy season. It would be running as soon as possible. Rates must meet the same standard as the private sector. The OIC has actuaries that would work on this issue. Only one quarter of the potential insureds in the area have NFIP coverage. That coverage may not be adequate for all of the businesses though. If there is a market, then there would be no MAP or JUA. If a MAP is all that is needed, there would be no JUA. Many service agencies in the area partnered to buy and renovate a building. After the renovation, the announcement of potential flooding was made. A check for coverage was returned because the insurers decided to not take the risk. Rates rose dramatically for coverage. Many of the insured properties are affordable housing units that were subsidized by the state. If the private market will not provide insurance, the state should provide an option. An insurer cancelled coverage in September. That coverage was purchased in June. Rates went up and coverage was reduced. Insurance is scarce for hundreds or thousands of businesses. The NFIP limits are too low. Businesses have to pay too much for insurance. Area governments and businesses have been taking preventative measures to limit flood damage. That brought attention to the issue and insurers overreacted to the media coverage. Where insurance is available, it is too expensive. Insurance was cancelled on the eve of the rainy season; the insurer took premiums for the summer months. Contracts with tenants have to allow the tenant the ability to get out of the lease if there is a flood. Businesses are leaving. If businesses leave or fail, it hurts the state's economy.

(With concerns) Flood coverage sold in the surplus lines is generally sold with earthquake coverage. The earthquake coverage is the more known part of the risk and is the bigger driver in price. The announcements by the Army Corps of Engineers (Corps) changed the known risk of a flood. The Commissioner has written affidavits from surplus lines brokers who are placing flood coverage in this area. The pricing of a JUA is supposed to be actuarially sound. When the risk of a flood was estimated as one in three by the government officials in charge of the dam, it changed rates considerably. It is not clear what the rates should be. The risk is still fluid. Rates are higher than previous years but do not seem unreasonable in the context of the amount of coverage and the likelihood of a flood. The number of policies sold did not change considerably from 2008 to 2009 despite the significant rise in the risk. The prices may be too high for the business but that does not mean that the price is too high for the risk. Property and casualty carriers take in \$8.5 billion in premiums in this state. If the liability due to a flood is several billion dollars, how can the

industry afford to pay that? Any scenario with a significant flood is devastating. A JUA will won't take all of the risk. The risk must be priced fairly and with the level of current risk, it may be unaffordable. The area maps are being studied. With flood coverage, pricing is more difficult. It is more about the elevation than past experience. So, the usual things that actuaries look at are not helpful. There have been very few known cancellations.

(Opposed) There is some availability in the market. The NFIP take-up did not seem to change much as the flood risk went up. Coverage from the NFIP is the first step in flood protection. Area residents and businesses are not buying the NFIP coverage. Few inquiries are being made of agents after the risk abated. The bill would create rather than solve problems. It may drive out the surplus lines and any admitted insurers. A MAP would be valuable. The Commissioner should have worked with industry on a MAP and properly inventoried the markets. The last MAP helped potential customers. The bill would require insurers who sell unrelated lines of coverage to participate. Commercial flood insurance for businesses would be subsidized by individuals' homeowners and auto policies and coverage like medical malpractice liability. A rate cannot be subsidized by other lines in the private sector. In the bill, that illegal subsidization will be required. The language making a finding of the Commissioner a rebuttable presumption is troublesome. That kind of presumption is not found in any state's insurance code. It should be removed. The JUA can turn down risks. So, the businesses that have been declined in the private market may be declined by the JUA. A JUA creates access to a type of coverage, but it does not mean that it will be affordable. If it is subsidized, that may allow the JUA to undercut the private market and price out the existing options. That is a negative and unintended but foreseeable consequence. Floods are devastating. Usually the only purchasers of flood coverage are those people that have a very high exposure to a flood. That is why the admitted market offers little coverage. People would only buy coverage if they thought a claim was likely. The risk pool is too shallow. That is why the NFIP was created. The high degree of risk means high premiums. Most of the concerns are about affordability, not availability. If the coverage is priced appropriately under the bill, it may still be too high for some of those businesses. A MAP is a good option. A JUA that is subsidized by other property and casualty policyholders is not a good option. The JUA does not solve the problem. The Corps indicated that they might deliberately cause the flood. That is not the type of thing that is generally insured against. There was no conversation prior to that about any issued in the flood market. Industry believes that the Commissioner could do a MAP today. Even if the Commissioner could not compel a MAP, insurers would be happy to discuss that kind of solution if the Commissioner asked the insurers to meet with the OIC. Insurers cannot discuss that type of solution without the Commissioner due to antitrust concerns. The OIC never contacted the industry on these issues. The bill will not lead to any timely results. A JUA could take months or a year. There does not seem to be a flood JUA in any state. The costs of a flood will be spread across industry and all property and casualty policyholders will have to subsidize this group of businesses. The insurers will take the assessments and can only pass those costs to their policyholders in this state. The bill does not cap the liability. There is no way to predict possible losses. There is no free money here. The admitted market has little experience with flood coverage. It is routinely excluded from policies. Coverage is usually through the NFIP or the surplus lines. A few months ago, the risk was publicly announced as one in three. It receded from that level. These policies are usually a year in length. Policies that were renewed at the time of the higher risk probably paid more. Those that renewed before that higher risk announcement probably paid less. The market is probably still adjusting to the

increased risk announcement and the later announcements that the risk had lessened. No one has hard data on this issue. Industry has always worked cooperatively on MAPs and in times of need. A few years ago, the Commissioner asked industry to work with policyholders with respect to issues related to the Lewis County floods. No member of industry refused the Commissioner. The Commissioner did not approach industry on this issue. The Commissioner announced to industry in October that the OIC would seek a general authority to do a JUA on any subject. There will be considerable pressure to push rates below market level to make the coverage more affordable. This would push out the existing market.

Staff Summary of Public Testimony (General Government Appropriations):

(In support) When problems with the Howard Hanson Dam were made public and the risk of a significant flood in the Green River Valley was one-in-three or one-in-four, businesses found that insurance policies were being cancelled or that flood insurance was not readily available. The Office of the Insurance Commissioner began working on this proposal as a result. The likelihood of a serious flood has decreased somewhat as a result of repairs to the dam and the passage of time, but businesses still find it hard to get flood insurance. The economic impact to the state and to businesses and people in the area would be devastating if a flood occurred and there continued to be a lack of available insurance protection. A JUA should be in place in case the insurance market is not adequate.

(Opposed) Flood insurance is available in the Green River Valley now through the insurance market. Establishing a JUA for this is not good public policy, and the Insurance Commissioner's Regulatory Account should not be used to fund OIC activity for the JUA. All property and casualty policy owners throughout the state will see their rates go up to subsidize flood insurance for businesses in the Green River Valley. This includes the state if it purchases property and casualty policies, and policies that have nothing to do with protecting real property such as malpractice insurance. Insurers would almost certainly cover their risk by purchasing reinsurance, the cost of which would be passed on to all property and casualty policyholders.

Persons Testifying (Financial Institutions & Insurance): (In support) Representative Orwall, prime sponsor; Mike Kreidler and Drew Bouton, Office of the Insurance Commissioner; Dini Duclos, Multi-Service Center; Mike Heinisch, Kent Youth and Family Services; Andrea Keikkala, Kent Chamber of Commerce; Suzette Cooke, Mayor, City of Kent; Theresa Hutchens, Plemmons Industries; Thomas McLaughlin, Center for Advanced Manufacturing Puget Sound (CAMPS); and Terry Davis, South Sound Chambers of Commerce Legislative Coalition.

(With concerns) Sam Alexander, Alexander Morford & Woo and Surplus Lines Association.

(Opposed) David Babbitt, Babbitt Insurance and Professional Insurance Agents Association; Mel Sorensen, Property Casualty Insurers Association; Jean Leonard, National Association of Mutual Insurance Companies; and Cliff Webster, American Insurance Association.

Persons Testifying (General Government Appropriations): (In support) Drew Bouton, Office of the Insurance Commissioner; and Doug Levy, Cities of Kent and Renton.

(Opposed) Mel Sorensen, Property Casualty Insurers Association; and Carrie Tellefson, Progressive Insurance.

Persons Signed In To Testify But Not Testifying (Financial Institutions & Insurance):
None.

Persons Signed In To Testify But Not Testifying (General Government Appropriations):
None.