FROM THE EDITOR

Disasters of all types have increased in recent years, but none more so than flooding. Once associated mainly with coastal and vulnerable lowland areas, floods are now impacting regions where they have never historically been considered a significant threat.

Compounding the devastation wherever flooding occurs has been the fact that flood damages are not covered in a standard homeowner or commercial insurance policy unless additional flood coverage is offered through a specific endorsement. Most commonly a property owner's only recourse has been to purchase the protection through the National Flood Insurance Program (NFIP).

But that is changing. As author Joseph Harrington explains in this issue of Adjusting Today,® *while the NFIP continues to be a viable option, the availability of coverage from private insurers is growing.*

Mr. Harrington discusses the protection private insurers are offering and compares it to the features of the federal program. It is vital reading for all of those who now face the more widespread risk of flooding.

Sheila E. Salvatore
Editor

FLOODING: Everyone is Exposed, Few are Insured, But New Options Entice

By Joseph S. Harrington, CPCU, ARP

Flooding is the most common and costly type of disaster in the United States, yet very few property owners are even partially insured for flood loss.[1]

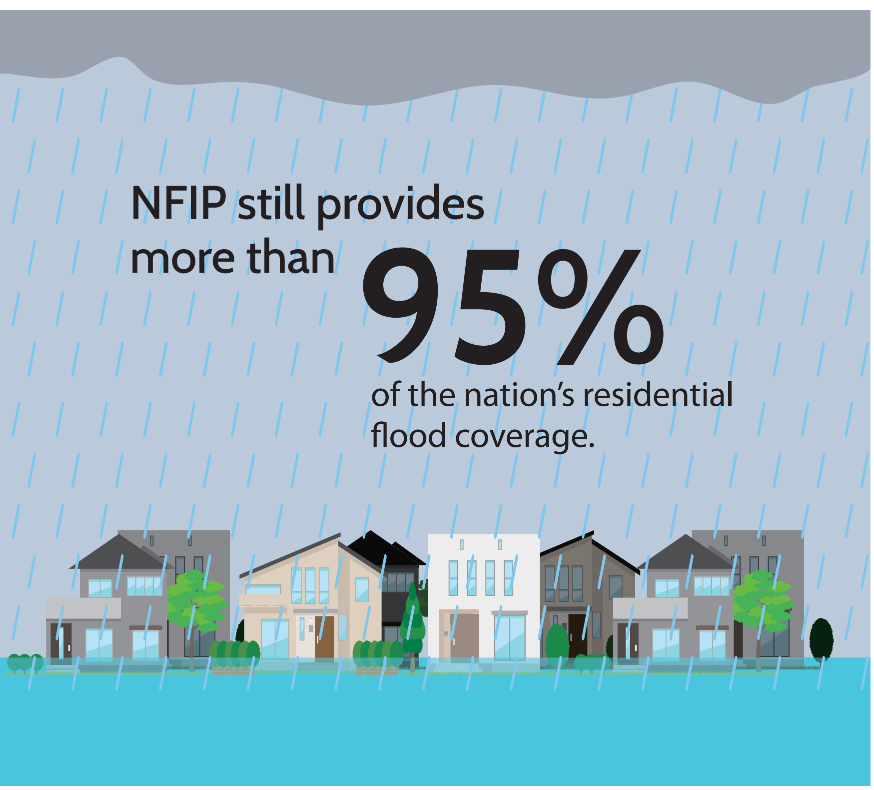
The federal government and private insurers are working to change that by promoting the development and purchase of private market flood insurance. There has been some progress to date, but the "take-up" rate for flood coverage still lags far behind the exposure.

During the two biggest flood events of the past decade — "Superstorm" Sandy which struck the Northeast in 2012, and Hurricane Harvey which inundated the Houston area in 2017 — fewer than 20 percent of the homes affected had flood insurance.[2]

Despite those and other highly publicized flood events, the number of policies written by the National Flood Insurance Program (NFIP) actually fell over the past 10 years, from a high of 5.7 million policies in 2009 to 5.2 million in 2018.[3]

Private flood insurance has picked up some of the slack, but not much; the NFIP still provides more than 95 percent of the nation's residential flood coverage.[4] Private insurers account for a much larger share of commercial flood insurance, but still less than half.

Between 2016 — when the National Association of Insurance Commissioners (NAIC) introduced an annual statement line for reporting private flood insurance — and 2018, the number of private insurers reporting private flood premium increased from 46 companies to 124. The amount of private flood premium reported over that period increased from $358 million to $681 million.[5]



There are two important qualifications to the private flood totals, however:

- The figures reflect changes in how premium is reported, and do not, on their own, signify an increase in private flood premium volume; and
- Nearly 40 percent of the private flood premium is reported by one company, FM Global, which specializes in broad property coverage — including flood coverage — for large industrial risks. FM Global accounted for nearly 70 percent of the increase in premium reported from 2017 to 2018.[6]

Leaders in the private and public sectors are hopeful that new techniques for measuring flood risk, plus a new requirement that mortgage lenders accept private flood policies that meet federal standards, will increase private market participation in protecting communities and property owners from flood losses.

Three Models

While little has changed in the overall market for flood insurance, much is changing regarding the flood insurance options available to property owners.

At the beginning of the 21st century about the only option most property owners had for purchasing flood coverage was to buy a policy from the NFIP. That policy might carry the brand of a private insurer under the NFIP's "Write Your Own" program, but the risk was assumed by the NFIP and, by extension, the U.S. Treasury.

The NFIP is still the "public option" so to speak for any property owner in the U.S. that seeks flood coverage. The NFIP cannot turn down an applicant in a participating community, and still offers subsidized rates for properties at high risk. In recent years, however, two alternatives have emerged for property owners:

- Stand-alone flood insurance written more or less on the basis of flood policy forms developed by the Insurance Services Office (ISO),[7] the largest advisory organization serving the U.S. property/casualty industry; and

- Flood coverage endorsements added to property policies, often in conjunction with major reinsurers able to spread their risk internationally.

Not all property owners will have all of these options, as private flood insurance is being most aggressively marketed in low-risk areas where private insurers believe they can charge a more competitive premium than the NFIP.

Nonetheless, there are enough players and variations in the private flood insurance market for property owners to consider how different approaches can address their needs.

NFIP and ISO Forms

The NFIP offers three different policies, for different types of property:[8]

- A Dwelling Form for covering a primary residence, detached garage and personal property;

> *The NFIP cannot turn down an applicant in a participating community, and still offers subsidized rates for properties at high risk.*

- A General Property Form for covering a commercial structure and business personal property (which can also be used to cover residential property); and

- A Residential Condominium Building Association Policy for covering a residential condominium building and its units, including personal property within the units.

Under the NFIP, each location must be insured under a separate policy and no location can be insured under more than one policy.

Since it was long believed that flood was uninsurable in a private voluntary market, NFIP policies were developed independent of standard property policies. Consequently, NFIP policy provisions do not always conform to or complement provisions in property policies from private insurers.

In contrast, flood policy forms developed by ISO in 2017 and 2018 utilize provisions similar to those included in ISO-based homeowners and commercial property forms. Thus, the NFIP and ISO flood forms differ in several ways.

Differences

Both the NFIP and ISO forms essentially define a flood as the overflow or inundation of surface waters, plus any mudslide that results.

The NFIP definition includes an important qualification, however: To trigger coverage under an NFIP policy, flood conditions must affect at least a two-acre area or two properties, including the policyholder's property. Thus, if your property is flooded but your neighbor's isn't, there's a chance you won't be able to recover under an NFIP policy.

This provision underscores the NFIP's historical purpose of addressing catastrophic floods and avoiding exposure to localized flood losses that could be managed by property owners on their own.

The ISO definition of flood contains no such qualification. Flood, typically an excluded cause of loss under property forms, is treated as a covered peril — although with limits structured a little differently than in other ISO-based property forms and with some provisions unique to the treatment of the flood hazard.

An ISO-based flood policy would thus respond to provide coverage for an inundation in a small area. It's no accident that the introduction of the new ISO flood program coincides with the development of new, refined flood mapping techniques that identify relative exposure to flood down to the level of feet and meters.[9]

The second major distinction between an NFIP policy and a private one based on an ISO flood form is the availability under the latter of coverage for loss of use, something not available at all under the NFIP.

The highest available limits under the NFIP are $250,000 for a dwelling, $100,000 for household contents, and $500,000 each for commercial buildings and business personal property.

Under an ISO-based personal flood form coverage is provided for additional living expenses and loss of rents due to a flood. That coverage extends to loss of use resulting from flood damage to neighboring properties that leads civil authorities to deny access to the insured residence.

Similarly, an ISO-based commercial flood form (comparable to the NFIP's "general property" policy) provides coverage for loss of income and extra expenses, including those incurred when access to the insured premises is prohibited due to flood damage at other locations.

Other Distinctions

There are other important distinctions between an NFIP flood policy and a private one modeled after the ISO form.

The highest available limits under the NFIP are $250,000 for a dwelling, $100,000 for household contents, and $500,000 each for commercial buildings and business personal property. Under a private program, the maximum allowable building and personal property limits can be higher or lower than the NFIP levels, depending on the underwriting appetite of the insurer.

While the NFIP dwelling policy will pay the full cost of replacing the insured residence, all other coverage offered under the NFIP is provided strictly on an actual cash value basis, meaning that the insured receives an amount equal to the depreciated value of the property. Both ISO programs offer options for replacement cost coverage, but the insurer has the discretion of whether to offer them.

The NFIP and ISO forms also differ in how they address certain remedial costs incurred after a flood loss.

Both the NFIP dwelling and general property forms include coverage up to $30,000 for "increased cost of compliance (ICC)." ICC refers to the increase in restoration costs due to requirements to adhere to flood loss mitigation standards when restoring flood-damaged property. ICC coverage under an NFIP policy applies only to structures that suffer two or more NFIP-covered losses over a 10-year period or damage from a single flood that amounts to at least half of a structure's market value.

ICC coverage is actually excluded under the ISO personal flood form, but is available by endorsement. The ISO commercial flood program offers three ICC options within the base form:

- Coverage for the increased cost of construction to floodplain management standards;
- Coverage for the cost to demolish a flood-damaged structure; and/or
- Coverage for "contingent loss assumption," which addresses the loss of value when demolition of an undamaged portion of a flood-damaged building is required.

In addition, the ISO program includes endorsement options for standard "increased cost-ordinance or law" coverage. That coverage pays the additional costs an insured will pay after a loss to bring the undamaged part of a structure into compliance with current building codes. That coverage is not available under the NFIP; private insurers would have the discretion of whether or not to offer it.

The DIC Option

In commercial lines, some insurers — most notably FM Global — have come to specialize in a type of property coverage known as "difference in conditions" or "DIC." DIC coverage is a class of inland marine insurance which is typically associated with transit risks but also includes other types of property coverage that is less regulated than standard lines of insurance. (*Adjusting Today*® issue #3042 features a more extensive discussion of Difference in Conditions coverage.)

For most practical purposes, DIC policies are used to add coverage for flood and earthquake to commercial property package programs. (Flood and earthquake are excluded from coverage under standard commercial property policies.) DIC polices typically have their own limits and coverage conditions, so that a flood loss does not trigger all the limits provided under a commercial property policy.

Of great importance to some property owners is the fact that DIC policies may automatically extend coverage for a specified period of time, typically 30-90 days, to additional structures the policyholder has purchased or constructed. This coverage for "newly acquired buildings" gives the insured property owner a "grace period" between the acquisition of a new location and the deadline for reporting the added exposure to the insurance company.

This coverage is not available under the NFIP or ISO flood programs.

A New Approach

Something new has emerged in personal lines where carriers and advisory organizations are introducing flood coverage endorsements with limits and conditions distinct from the underlying homeowners or dwelling policy.

International reinsurers have taken the lead in promoting private residential flood insurance in the U.S. One example of their efforts is the Inland Flood Coverage endorsement provided by MSO, Inc.,

> *"DIC policies typically have their own limits and coverage conditions, so that a flood loss does not trigger all the limits provided under a commercial property policy."*

formerly the Mutual Services Office. Like ISO, MSO is a property/casualty advisory organization licensed in 48 states to file policy forms and advisory loss costs on behalf of its member insurance companies.

As its name suggests, the MSO Inland Flood Coverage, developed in conjunction with Munich Re, is available for adding flood coverage to residential property policies in inland areas and is not intended for coastal properties facing storm surge.

Under the endorsement, part of the overall building and personal property limits is made available to address flood loss, subject to per-occurrence and aggregate limits. The flood coverage falls within and does not add to the base policy property limits.

Within the MSO flood coverage limits there are per-occurrence and aggregate sublimits for (1) personal property in basements and (2) increased expense and loss of rental income. In addition, there is an aggregate limit for losses due to fungi and mold, a condition that often arises following a flood. Again, the sublimits are part of and do not add to the flood limits, which are also applied within the basic policy limits.

The purpose of the initiative — which Munich Re has undertaken with other advisory organizations — is not to add to the amount of insurance but to allow some of it to be directed to flood loss. This spares homeowners insurers and their policyholders the frustration of having no coverage at all in place following a flood loss.

The Jury is Out

Whether this and other initiatives will significantly expand the number of properties insured for flood remains to be seen. But it’s clear that more and more property owners have insurance options for protecting themselves against flood losses.

Dealing with Property in Basements and Below Grade

When considering flood insurance for a residential property, the property owner needs to be aware of key limitations regarding coverage for property in basements.

Under an NFIP flood form, a basement is defined as "any area of the building, including any sunken room or sunken portion of a room, having its floor subgrade (below ground level) on all sides." However, a room is not considered a basement if (1) it is below grade on three sides, and (2) has a door that opens out onto dry land that is lower than the subgrade floor.

The following types of property are not covered under an NFIP Dwelling Policy when in a basement:

- Personal property;
- Finished walls, floors and ceilings;
- Doors and cabinets;
- Stoves and dishwashers; and
- Building equipment not identified as covered.

Coverage under an NFIP form is restricted to the following types of property in a basement, along with related clean-up costs:

- Drywall and ceilings (excluding the cost to paint them);
- Backed-up sewer lines;
- Sump pumps;
- Heat pumps;
- Water tanks and pumps;
- Fuel tanks, including the fuel in them;
- Cisterns and the water in them;
- Central air conditioners;
- Non-flammable insulation;
- Furnaces and water heaters;
- Clothes washers and dryers;
- Freezers and food stored in them;
- Electrical junction and circuit breaker boxes;
- Attached, not separated stairways and staircases; and
- Elevators, dumbwaiters and related equipment, unless installed below the base flood level after Oct. 1, 1987.

Under the ISO Personal Flood form used as a basis for some private residential flood policies, there is no restriction on coverage for building property in levels that are below grade or below the lowest level of an elevated structure. Coverage is also explicitly extended to building equipment installed to service a building or detached garage.

The ISO Personal Flood form excludes coverage for personal property "in a below ground area" (e.g., a basement) but also includes an exception preserving coverage for functioning air conditioners; clothes washers and dryers; and refrigerators and freezers, including the food in them.

Comparing Potential Personal Flood Options

NOTE: For purposes of simplicity, all entries in the table are abridgements and/or paraphrases of policy provisions. Consult the actual policy provisions for definitive statements of coverage.

Topic	NFIP Dwelling Policy	ISO Personal Flood Program	MSO-Munich Re Inland Flood endorsement
Definition of flood	Inundation of two or more acres of normally dry land area, or of two or more properties, including the insured's, due to: • Overflow of inland or tidal waters, • Unusual and rapid accumulation of surface waters, and • Mudflow. Extends to collapse of land on a lakeshore eroded by a flood.	Reads much the same as the NFIP definition except that there is no qualification that the flooding affect a two-acre area or two properties.	Reads much the same as the NFIP and ISO definitions, without the two-acre/two-property qualification, and states explicitly that inland floods do not include tsunamis.
Coverage for damage to principal dwelling	Buildings and fixtures covered on a replacement cost or actual cash value basis under a building property limit up to $250,000.	Buildings and fixtures covered on a replacement cost or actual cash value basis under a single Cov. A—Dwelling and Cov. B—Detached Garage limit established per company underwriting.	Pays up to per-occurrence and aggregate limits under a single separate inland flood limit. Loss settlement terms (replacement cost or actual cash value) determined in the base policy.
Coverage for damage to related private structures (e.g., detached garages)	Covered within the building property limit, up to 10% of the limit.	Cov. B pays up to 10% of the building limit and depletes that limit; full coverage for detached garages available by endorsement.	Same as above
Coverage for loss to personal property (contents)	Contents and unattached furnishings covered up to $100,000 on an actual cash value basis. Contents must be within an enclosed building or secured to prevent flotation.	Covered on an actual cash value basis under a limit determined by the insurer; option available for replacement cost coverage.	Same as above. Separate per-occurrence and aggregate sublimits established for property in basements.
Coverage for additional living expenses/loss of rents	Not available	Available under a separate limit determined by the insurer; extends to situations where public authorities prevent access due to flood loss at other locations.	Available under its own per-occurrence and aggregate sublimits under the applicable inland flood limit.
Increased cost of compliance (covers costs to demolish or move structures to comply with flood regulations)	Covered to $30,000 for "repetitive loss structures" that have sustained damage of at least half their value.	Excluded in the form, but available by endorsement on terms equivalent to those in the NFIP form.	Not addressed
Increased cost—ordinance or law (covers additional costs to bring undamaged parts of building property up to code)	Not available	Available by endorsement	No coverage. Endorsement explicitly excludes coverage for increased cost—ordinance or law due to flood. The increased cost—ordinance or law coverage in the base policy applies only to loss by perils insured under that policy.

Comparing Potential Commercial Flood Options

NOTE: For purposes of simplicity, all entries in the table are abridgements and/or paraphrases of policy provisions. Consult the actual policy provisions for definitive statements of coverage.

Topic	NFIP Dwelling Policy	ISO Commercial Property Flood Endorsement (CP 10 65)	Difference in Conditions policy	ISO Commercial Flood Program
Coverage for damage to building property	Covered under a building property limit up to $500,000.	Provides coverage under separate flood limits of insurance for property indicated in a schedule or the policy declarations.	Typically provides coverage under separate limits for loss due to flood and earthquake.	Covered under a single building and business personal property limit set by the insurer and applicable on a blanket or scheduled basis.
Coverage for loss to business personal property	Covered under a separate personal property limit up to $500,000.	Same as above. Covered property in the open must be described in the accompanying schedule.	Same as above	Same as above. To be covered, personal property must be within an enclosed building at an insured location.
Coverage for loss of income and extra expenses needed to resume operations	Not available	Blanket or scheduled limits (per location) indicated on the schedule.	Typically excluded in a DIC form but may become available for flood under a business income-extra expense form in a commercial package.	Options for covering these losses: • Business income and extended business income; • Extra expenses to resume operations; • Loss of ingress and egress, including by order of civil authority; and • Increased period of restoration to comply with a building ordinance or law coverage (if covered)
Increased cost of compliance (covers added costs to elevate, floodproof, move or demolish a structure to comply with floodplain management rules)	Covered to $30,000 for "repetitive loss structures" that have sustained damage of at least half their value.	Not addressed	Not addressed	Choice of three optional limits: • Increased cost of construction • Demolition cost • Contingent loss assumption
Increased cost—ordinance or law (covers added costs to bring undamaged parts of damaged structures property up to code)	Not available	Coverage excluded within the CP 10 65.	Coverage may be built into the policy or available by endorsement.	Available by endorsement
Primary or excess coverage	Almost always serves as primary flood coverage.	Coverage is primary in the absence of an NFIP policy or excess over an NFIP policy.	Typically written on a "wrap around" basis to complement the base property policy.	Can be written as primary or excess, and on a "wrap around" basis.

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