

TESTIMONY OF MARK DAVEY
BEFORE
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
CONCERNING
THE NATIONAL FLOOD INSURANCE PROGRAM
ON BEHALF OF
FIDELITY NATIONAL PROPERTY AND CASUALTY INSURANCE GROUP

My name is Mark Davey and I am President and CEO of Fidelity National Property and Casualty Insurance Group. The Fidelity National Property and Casualty Group consists of the P & C Companies; Fidelity National Insurance Company (FNIC), Fidelity National Property and Casualty Insurance Company (FNPAC) and Fidelity National Indemnity Insurance Company (FNII). Through these three companies policies are underwritten in all 50 states for flood, personal lines and niche commercial programs.

Fidelity is currently the largest provider of flood insurance through the NFIP. We service this business through a large flood processing center located in St. Petersburg, Florida. A staff of approximately 185 flood specialists is exclusively dedicated to supporting the NFIP Flood product line. In addition Fidelity has 28 full time sales associates focused exclusively on flood insurance.

Fidelity's Flood insurance is sold by approximately 15,000 independent agents and brokers throughout the United States. Fidelity's 2006 written premium of \$398 million represents approximately 15% of the NFIP program. Fidelity is on track to produce in excess of \$430 million for calendar year 2007. We are confident this makes us the largest provider of the National Flood Insurance Program's policies in the country. Fidelity is one of 88 property and casualty insurance companies marketing and administering policies on behalf of the NFIP.

Fidelity has established an excellent reputation for policy and claims service. Since entering the property and casualty business in 2001 and becoming a representative carrier for the National Flood Insurance Program in 2003 it has received the NFIP's Administrator's Quill Award, in recognition for excellence in service and marketing three times. We have complied with all audit requirements through either Biennial audits or KPMG audits sponsored by FEMA. Fidelity takes great pride in providing the most innovative policy quoting and issuance platforms in the industry. Fidelity constantly strives to expand its product lines and enhance our customers' experience.

How the NFIP Works

Fidelity and other carriers who market and service on behalf of the NFIP fulfill all obligations of a traditional insurance company with one major exception, that being the insurance companies do not assume the policyholder risk. The actual risk is 100% underwritten by the Federal Government through the National Flood Insurance Program. Insurance companies are responsible for all marketing, policy quotation, sale, issuance and servicing, in addition to all claims handling and claims payment. Currently Fidelity and all the other participating companies receive an expense reimbursement of 30.2 percent for the policy issuance, servicing and marketing. Fidelity and other NFIP representing companies also receive a 3.3% claims administration fee when claims are adjusted and paid. The 30.2% processing fee is used to pay independent agency commissions, processing costs, marketing costs, and state premium taxes.

While the insurance industry has reduced their underwriting costs for traditional lines through automation and better processing techniques, flood insurance has become more cumbersome to rate and process. Marketing, administering and interfacing with the NFIP is a truly specialized field. The rating process requires actual location information such as flood zone, determining elevation, reviewing pictures, and numerous forms to determine the correct rate for the property. This process does not lend itself to high automation. Flood insurance is a very

complex product. The longtime viability of any line of insurance is achieved through spread of risk, and flood is no different. The vast majority of flood insurance policies are written in mandatory flood zones. Despite our experience in the wake of Katrina, few people ever believe they will experience a flood. And if they do flood, they don't think it will happen again; as a result, maintaining a spread of risk is very difficult.

Proposed Reforms to the NFIP

While Katrina was an anomaly during the life of the flood program, we must be proactive in reforming the program to ensure its long term viability. Our recommended changes include:

1. Funding must remain intact for FEMA's Map Modernization program. There were far too many years when funding was not available that maps were not updated. It has been a monumental task for the Map Modernization to be where they are now in the process. This process must continue and must be ongoing as the floodplain changes; the flood maps must also be updated.
2. Tracking must improve to ensure properties in high risk zones are covered for the life of the loan and not just at loan origination. Far too often policyholders are allowed to let their coverage lapse.
3. Provide for the reauthorization of the program for ten years. Shorter reauthorizations jeopardize the programs efficiency and have caused major disruption in the market place as recently as 2003 when the program was allowed to lapse.
4. The program should expand the mandatory purchase requirement to include additional properties at risk. Properties that are located behind a levee or other protective barrier, or are located near the coast of a major body of water are often in serious danger of flooding. Mandatory purchase requirements should not be limited only to those located in Special Flood Hazard Flood areas.
5. In order to reduce litigation, which significantly raises operational costs for all stakeholders, the federal NFIP statute must affirm federal court jurisdiction over all disputes relating to procurement of a policy and adjustment of claims under this program.
6. The program should increase the maximum coverage limits above the current available limits. The option to insure all buildings to their replacement cost value should be included.
7. Review and amend the Unallocated Loss Adjustment Expense to achieve adequacy for the program and the Write Your Own companies in both catastrophic and non-catastrophic years.
8. Revise and rewrite the Standard Flood Insurance Policy to make it more consistent with standard homeowners and other property/casualty insurance products.
9. Policy rating should be simpler and less cumbersome so that the risk can be rated accurately and quickly.
10. Disaster assistance procedures should be changed to ensure that those with flood insurance are paid ahead of those who have not purchased flood insurance.
11. Lenders should be required to establish escrows for policies outside the Special Flood Hazard Areas.
12. Provide additional educational materials and strengthen requirements for flood protection.
13. Maintain oversight of Write Your Own companies through biennial audits.

Expense Reimbursements and the GAO Report

One of the reforms that was discussed in last year's reform efforts is a significant reduction in expense reimbursements. That discussion is likely to be renewed in the wake of the GAO study released last month entitled, "FEMA's Management and Oversight of Payments for Insurance Company Services Should be Improved." I believe that the study seriously misrepresents the expense reimbursement issue and I feel compelled to address those misrepresentations.

It was quite disconcerting to review the GAO study and see a chapter heading that said, "Payments to WYO Insurance Companies Comprised Up to Almost Two-Thirds of Total Premium Revenue in Recent Years Based on Payment Methodologies Established in 1983". This has led to criticism of the WYO companies amidst claims that we are receiving in excess of 60% commissions on the policies we sell. That is simply not the case. The claims administration fees and adjusting fees cannot be disregarded when examining this period. As the GAO's report states, prior to the unprecedented and incomprehensible events of 2005 the National Flood Insurance Program was self-sustaining. Relatively speaking, I would argue that the program prior to 2005 was efficiently fulfilling its mandated cause in a fiscally responsible manner. The early drafters of this program should be commended for creating a program in 1968 which has performed as designed with little modification for almost 40 years. The science of statistics is one of our most powerful analytical tools available today. However, when statistics are

quoted and utilized out of context their destructive incorrect inferences can cause substantial damage. The utilization of the individual data components to validate the above referenced statement is factual, but when taken out of context it is extremely misleading. Katrina not only highlighted the need to examine specific components of the NFIP, it also forced policy makers, businesses and individuals to rethink an extremely broad range of practices and policies. Relating to the NFIP claims funding and administration process, we need to analyze the basic funding mechanisms and administration models to properly and adequately respond to future events of Katrina's magnitude.

I am troubled by the tone and inferences made in some sections of the report. We followed set protocols to the letter. When granted additional flexibility to expedite our process, we declined in most instances. We were compelled to adhere to our standard diligent claims process and individually examine each and every claim on its own merits. To the best of my knowledge, every dollar paid for flood damage went towards actual documented flood damage. We were good fiduciaries of the Federal Government's monies. We should not be faulted for following protocol as set forth by regulation and for receiving the commensurate fees as provided by the same regulations. Based on recent events should the claims administration fees structure be reviewed? Yes. We stand ready and willing to participate in any review and redrafting process to make the NFIP a better program for non-cat times and truly catastrophic times.

We know the policy administration expense reimbursement provisions are being re-evaluated. We believe the present mechanisms in place perform very well. Efficiency in one's operations are rewarded, while inefficiencies are unsustainable. The economics for the production and administration facets of the NFIP are fair and not excessive. The current plan properly motivates companies to increase the penetration of the NFIP product sale in flood prone areas. The expense reimbursement mechanisms are in line with their respective expenses incurred by the Write Your Own carrier. We stand ready to review our carriers' actual expenses with FEMA and other interested parties. We can clearly demonstrate that they are not excessive. I believe our organization is one of the most efficient WYO companies.

We have complied with the required bi-annual audit requirement. We feel it is essential that all companies immediately take the necessary actions to be compliant with specified existing requirements. The NFIP must create the necessary infrastructure to review all information obtained through the audit process and take immediate action as warranted.

It is worth noting that 95% of Katrina and Rita claims were settled by May of 2006, about 9 months after the storm. I cannot speak for other carriers, but in regards to our NFIP policyholders, we believe we qualified and paid our policyholders NFIP claims per the prescribed guidelines fairly and professionally. I know we had one of the largest claims loads of all WYO carriers and I am proud of the response we provided to our customers. We did everything possible to make certain we assisted our customers while strictly adhering to the NFIP's prescribed claims handling processes and policy provisions. We take our fiscal responsibility to the Federal Government very seriously.

Thank you, acting chairman Carper, ranking member Shelby and members of the Senate Banking Committee for the opportunity to appear before you today on behalf of Fidelity National and present our views on the National Flood Insurance Program and how this federal program should be improved.