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Statement of the National Association of Mutual Insurance Companies

to the

United States House of Representatives Financial Services Subcommittee on Housing and Insurance

Hearing entitled "Vanishing Independence: How FHFA's Political Agenda Endangers Homeowners and Taxpayers"

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Introduction

The National Association of Mutual Insurance Companies (NAMIC) is pleased with the opportunity to provide testimony for the House Financial Services Subcommittee on Housing and Insurance hearing on recent Federal Housing Finance Agency decisions and the economic harm they could bring to the U.S. marketplace.

NAMIC is the largest property/casualty insurance trade group with a diverse membership of nearly 1,500 local, regional, and national member companies, including seven of the top 10 property/casualty insurers in the United States. NAMIC member companies represent a cross-section of the property/casualty insurance industry ranging in size from a one-person farm mutual operating in a single county to local and regional insurers on main streets across America to national insurers operating throughout the country and around the globe.

NAMIC members write $391 billion in annual premiums, accounting for 68 percent of the homeowners insurance market, 56 percent of the auto market and 31 percent of business insurance markets. Through our advocacy programs, we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve, and we foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

This testimony focuses on one aspect of Fannie Mae and Freddie Mac's instruction/encouragement to require home consumers with a federally-backed mortgage to secure full replacement cost insurance. In an effort to assist in shared goals for consumer choice and coverage, we convey significant concerns for both insurance markets and the consumers they serve if the directive takes effect and is fully enforced. Before turning to these impacts, some background information about the prompt for these concerns would provide useful context for this discussion.

Fannie Mae, Freddie Mac Guide/Announcement (February 2024): Additional Background

In February, the GSEs announced in lending selling/servicer directive materials[1] that it was their expectation that homeowners insurance claims must be settled on a replacement cost basis and that insurance policies that provide for claims to be settled at actual cash value or less than replacement cost would not be eligible for a GSE-backed loan. Further, the guidance stated that the seller/servicer must verify the replacement cost annually. In short, consumers would be limited to only one kind of insurance policy – and likely a more expensive insurance policy in the market – in purchasing coverage to satisfy these requirements, and the valuation would need to be confirmed each and every year through a process yet to be established or defined. Consumers currently have a variety of insurance products available from which they can choose , commensurate with their exposure both to risk and investment in the property. The impact of this directive would be extensive, removing those choices – where a consumer can opt to match their needs – and replacing them with a one-size-fits-all policy that may not reflect the insurance

[1] As we understand it, new/revised GSE materials were documented in: Selling Guide Announcement (SE-2024-01) (Fannie Mae: Feb. 7, 2024), Servicing Guide Announcement (SVC-2024-01) (Fannie Mae: Feb. 14, 2024), Selling Guide Chapter B (Fannie Mae: Feb. 13, 2024, updating B-2-01, B-2-03, B-3-01), Bulletin 2024-1: Selling (Freddie Mac: Feb, 7, 2024), Seller/Servicer Guide Sec. 4703.2: Minimum Property Insurance Types and Amounts (Freddie Mac), and Seller/Servicer Guide Sec. 4703.3: Flood Insurance (Freddie Mac). The GSE materials are referred to as "directives" here.

coverage that they want or need.

These changes may cause many consumers across the country to experience major changes to their insurance policies – changes that would likely drive-up costs significantly and that may not serve their needs. As a practical matter, the marketplace would be impacted dramatically by these changes, and homeowners would be forced to purchase a higher-cost insurance product to satisfy the new coverage requirements.

Upon learning of the directive, NAMIC encouraged the GSEs not to proceed with implementation and enforcement in order for them to fully consider the complexity of issues and the breadth of implications, including: the significant burdens and/or disruptions these directives would likely create for many consumers (and potentially for the businesses supporting them); possible unintended consequences on the insurance marketplace, including reducing availability and affordability of coverage; and the lack of infrastructure or mechanisms to meet expectations relating to annual valuation verification.

As this matter is considered, NAMIC looks forward to highlighting the important role that the variety of insurance products can play in markets and how that diversity best serves consumers. Generally, consumer choice in insurance products is an important aspect in not only driving competition but also increasing availability and affordability of insurance across all sectors. It follows then that a reduction in choice can harm availability for consumers and thereby counteract the shared goals of consumer protection and increased access to home ownership.

Limiting Consumers' Choices in Insurance Products: Negative Impacts on Individuals

The directive language states, "claims must be settled on a replacement cost basis" and provide that "insurance policies that provide for claims to be settled at actual cash value or limit, depreciate, reduce or otherwise settle losses for less than a replacement cost are not eligible," would directly impact many insurance consumers.[2] In explaining that impact, we briefly explain some of the policy approaches currently in the marketplace along with the reasons why a consumer may decide to purchase different kinds of policies.

The GSE materials seem to categorize policies as either replacement cost valuation policies (RCV) or actual cash value policies (ACV), with anything that is not full RCV precluded under GSE directive. In actuality, there are more than two approaches to handing valuation through insurance, and these reflect a range of ways to reflect the risk the consumer is transferring with the policy. The existence of different products benefits consumers because they meet different needs and price points. It cannot be emphasized enough that an absolute restriction that limits the kind of contract that satisfies eligibility for GSE-backed mortgages to only replacement cost is too narrow and will leave consumers with fewer options and likely higher costs as well.

Consider the important reasons why a broader array of products/options should be available in the market – a few are highlighted below:

- **Older Historic Homes**: Many areas across the country have older homes, and as people buy those homes, they may opt for ACV coverage for a number of reasons. For example, imagine a first-time homebuyer purchased a bargain-priced fixer-upper Victorian home. A home could be purchased at $80,000 but have a replacement cost of $300,000 (which is

[2] Freddie Mac Services Updated Bulletin (February 2024).

substantially above their loan amount and may impact their payment-to-income ratio). In this scenario, home buyers are unlikely to want to insure at replacement cost, as that home would cost much more to replace than the market value. This dynamic may apply in the case of many older, lower value, or more deeply discounted homes. It would seem surprising for the GSEs to intend for this section of the market to not be fully served, given FHFA's focus on supporting first-time homebuyers, who are likely to choose older homes at a lower cost.

- **Manufactured Homes**: Consumers who purchase these homes face a unique set of circumstances and stand to face a significant set of challenges due to the directive change. This alternative to site-built homes attracts many buyers due to the lower initial investment (especially where it may have a higher market value than many older homes). Many consumers desire to insure the property for their purchase price rather than replacement cost, which again could be much more than the market value of the property.

- **Investment properties**: Some investors may purchase homes to rent, but because the condition of some of these properties may not be recently updated, they may not insure to the full replacement cost. It is important to consider possible impacts to properties and neighborhoods if, when required to purchase full replacement cost, owners opt to exit their investment and appetite for further investment in the community decreases. There also may be downstream impacts to renters who could face higher monthly payments to make up for the increase in insurance premiums.

- **Roofs**: Today, there may also be a range of product options for valuation methods specific to the roof. Not all roofs are the same age, built to the same standards and with the same materials, or subject to the same kinds of perils. Further, with possible changes in storm frequency, severity, and locations – and in light of higher losses also being somewhat driven by unscrupulous actors knocking on doors after storms and driving up costs for consumers and their insurers – it appears less common for roofs to last 20-30 years. While practices differ between insurers, roofs should not be subject to a one-size-fits-all replacement cost approach. Where it is transparent, and whether it is on an actual cash value (ACV) basis (allowing for depreciation) or on an explicit schedule (as a means of cost-sharing), insurers and consumers should be able to find ways to address the challenges posed by roofs. The roof-related claim settlement approaches in the market today help meet the needs of properties in a range of conditions as well as customers' means. The approach has been filed with insurance regulators who manage availability and affordability in their state markets.

- **Other Coverages**: Other aspects, such as contents and belongings, may be covered on an ACV basis. This is one option a consumer may choose to keep costs down. And because these aspects have no direct impact on the mortgaged physical property – or on the value of the loan – this is a very clear example of the unintended overreach of one-size-fits-all RCV homeowners insurance directives from the GSEs. After all, this aspect of an insurance policy does not relate to the value of the home and the contents of the home would not likely be part of a GSE-backed loan.

Consumers may wish to choose different kinds of coverage to lower their costs and should have the option to do so. Indeed, the importance of consumer choice is also evidenced by FEMA's inclusion of ACV as an alternative settlement option for National Flood Insurance Program policies. Consumers have different needs and circumstances and, when the amount of their loan is not in jeopardy, they deserve to be able to determine what type of policy is right for their home. It is difficult to imagine that the directive approach would not have the practical impact of many

consumers with GSE-backed loans having fewer and more expensive homeowners insurance options. And these impacts may not be limited to new insurance policies; they may also be felt at annual renewal time for those with existing mortgages where insurance products meeting the GSEs' requirements may not be available.

When the amount of insurance coverage is adequate to meet the value of a loan, the GSEs should not restrict the consumer's ability to make an informed choice. While positive intentions may be driving the desire for a simplified insurance landscape where all consumers buy RCV coverage, removing choice ignores important realities, complexities, and consequences.

Reducing Healthy Diversity and Competition in Homeowners: Disruptive Impacts on Individuals and Marketplaces for Homes & Homeowners Insurance

Requiring replacement cost across the board appears likely to have downstream impacts on the marketplaces for both homes and the insurance on those homes.

FHFA has indicated that one of its main goals is to increase the number of Americans who are able achieve homeownership so more generations of Americans can build wealth and financial security. This is an important and worthy goal. However, if the directive moves forward, consumers may be likely to face more cost barriers when purchasing homeowners insurance and limited availability depending on the area. This is especially true for lower cost homes and first-time homebuyers. With fewer products – and price points – from which to choose, as shown in the older historic home example above when the replacement cost is significantly above a loan amount, it is inconceivable that a payment-to-income ratio could not be impacted. And if that is the case, it seems logical that there could be unintended consequences for home affordability. Among recent news articles on increasing costs, the Wall Street Journal reported on homeownership affordability falling to "its lowest level since the 1980s," pointing to the impact of not just record high mortgage rates and home prices, but also of increases in "[n]on-mortgage costs including property taxes, maintenance, utilities and insurance." The Journal states that "many first-time buyers will continue to find homeownership a financial stretch." Indeed, insurance costs were featured in the article.[3] Unfortunately, to the extent the GSEs' mandate exacerbates affordability concerns, they impact many consumers negatively when it comes to both homeownership as well as insurance to cover such homes.

Beyond insurance affordability, additional availability challenges also seem a probable implication of the GSEs' restriction. Consider residual markets (which may be known as FAIR plans) – or the insurance markets of last resort in the states. Potential increased challenges for consumers to find private insurance coverage (whether short term or longer term), could lead to an influx into the state residual market, if they have not already. However, relying on the residual market to bridge this difference does not seem feasible, especially in the shorter term, because some of those organizations may not be ready with policies and the ability to administratively handle such a change. Additionally, not all FAIR plans use replacement cost forms exclusively,[4] so there could be a scenario where a homeowner may only be able to afford an ACV policy from their state's FAIR plan, and it is up in the air how that would be resolved.

When it comes to the consumer experience, especially in the context of buying a home, not being able to readily secure insurance coverage consistent with the GSE requirements is likely

[3] Friedman, Nicole. "The Hidden Costs of Homeownership Are Skyrocketing." *Wall Street Journal*, 10 Apr. 2024.
[4] For example, see Texas Ins. Sec. 2210.207 and 28 TAC Sec. 5.952.

to be a source of significant frustration for consumers. Again, as explained above, there are important reasons why a range of products should be available in the market.

As will be discussed below, homeowners insurance products/prices generally must be filed with the state insurance departments. Not all insurers have current filings for (or have broad offerings in the marketplace) for full RCV coverage consistent with the approach articulated in the GSE mandate. This is a very practical limitation on the scope of market availability today.

This is not the only dynamic occurring in the homeowners insurance market today. A confluence of other factors has been impacting costs, including, but not limited to: extreme weather, climate-related impacts, inflation, dislocation in the reinsurance market, migration and development in high-risk areas, regulatory challenges in certain states, legal system abuse, and the need for strengthening our built environment. The phrase "everything, everywhere, all at once," may best describe the dimensions of the challenges insurers face. With these risk/events occurring at the same time, disruptions are affecting nearly all lines of business, types of policyholders, in virtually every part of the country, with certain regions more impacted than others.

Deviating from Core Regulatory Functions:
Altering decisions made by state insurance regulators; and
Acting beyond protecting the value of a loan for safety and soundness purposes

While likely well-intentioned, the GSEs' directive seems part of a broader theme of growing federal government involvement in regulation of the insurance sector.

As a practical matter, the directive governing eligibility for GSE-backed loans demonstrated a potential regulatory loophole where Fannie Mae and Freddie Mac could essentially use entities directly subject to their requirements as a lever to enact public policy and regulatory decisions applicable to an industry outside of their direct authority. This highlights a path for such actions being taken without the kinds of administrative protections that would ordinarily be required through transparent and official regulatory channels.

While not their goal, FHFA and the GSEs' actions have the potential to create a problem for consumers, regulators, agents, and insurers nationwide. If fully enacted and enforced, the practical effect of these steps appears likely to impair, conflict with, or supersede state insurance laws and regulations – and therefore they arguably may conflict with Congress's long-standing delegation of insurance regulation to the states as enacted in 1945 through the McCarran-Ferguson Act. To the extent the GSE directive was intended to dictate insurer practices, these changes were not created pursuant to rulemaking or authorized by statute.

Additional information about the insurance regulatory filings system may provide a glimpse into the directive's possible repercussions: for an insurer to change the current insurance product offerings it has available in the marketplace to meet expected changes in lender (and thereby consumer) demands for a specific insurance product, a series of internal and regulatory steps likely have to occur. To generalize, in most states homeowners insurance policy forms, rates, and in some instances their guidelines, cannot be used unless they are filed and approved. As a practical matter, the state filing review process to bring new/revised forms/rates/rules to market may take 18 months or longer. This would be in addition to any time needed to develop such products, price them, prepare for filing submission, and any filing backlog resulting from this GSE change. To underscore the point, these filings, and the products/prices available in a state, are the purview of

those state insurance commissioners.

FHFA has signaled interest in getting more involved in insurance matters, beyond the directive under discussion here.

- **Symposiums**: For example, in the last year, the agency held several insurance-related symposiums. While hosting discussions is not harmful in and of itself, the subject matter of some events explored federal government interventions in the insurance market while not devoting significant discussion to topics that would focus on reducing risk - as in this forum, solutions should bolster federal policies on resilience and mitigation as well as on the underlying risk and not venturing into areas of the state-based system of insurance regulation. Indeed, risk reduction benefits everyone; it is not an insurance-specific topic. There are many ways Congress and the federal government could reduce risk through resiliency and improving the built environment to counter increased climate risk, promote smarter land use, and reining in legal system abuse.

- **Policy Initiatives**: The insurance valuation related activity discussed in these comments is just one of the areas where FHFA has been unexpectedly active. Interestingly, concurrent with this activity, it appears that FHFA may be showing an increased risk appetite through its approval of Freddie Mac launching a pilot program to purchase and guarantee single-family close-end second mortgages. Also, while not the focus of these comments, another recent example of FHFA taking action which appears to be overreaching of its authority is in title insurance (which is also state regulated and outside of the their expertise/authority). Together these initiatives do not appear cohesive because they may have differing public policy justifications and reflect differing understandings of markets and risks.

Even putting aside questions of authority, the FHFA and GSEs making extensive and large-scale changes – without insurance functional regulator expertise or thoughtful insurance stakeholder feedback – is concerning given the real world consequences for individual consumers and for markets. The highly technical field of insurance regulation is occupied by insurance regulators with a mission of protecting insurance consumers and the insurance marketplace.

Looking Forward

The reach of the recent GSE directive would extend far beyond the sellers/servicers subject to Fannie Mae and Freddie Mac's oversight, and would appear to have significant negative impacts on homeownership, the market, and consumers. How the GSEs accomplish their goals are not a trivial matter, as their directive has the potential to reduce the availability/affordability of insurance; frustrate, confuse, or limit insurance options for consumers; and impact the business of insurance in a way that poses McCarran-Ferguson challenges.

Respectfully, FHFA and GSE efforts should not be broader than reasonably necessary to protect the safety and soundness of federally-backed loans. They should be tailored accordingly. And, however well intended, they must not make sweeping restrictions on the insurance sector that is regulated by experts with authority to oversee homeowners insurance.

Homeowners insurance plays a crucial role in protecting many consumers' biggest asset and wealth building tool. It is important FHFA and the GSEs understand the potential downstream impacts of their decisions and ensure a more thoughtful process moving forward when considering new ideas. While the directive change was a step in the wrong direction in addressing risk in the

insurance marketplace, it was a positive development that the directive was paused and that a serious stakeholder feedback effort has been launched. It is our hope that this informed and collaborative approach will work towards a solution that preserves consumer choice and affordability.

NAMIC appreciates the opportunity to testify before the committee on this critical issue and looks forward to collaborating and engaging on this topic long-term.