Federal Housing Finance Agency

Office of the Director

400 7th Street SW

10th Floor

Washington, DC

20219

Re: Written Comments responding to FHFA Request for Input on Climate and Natural Disaster Risk Management

Director:

This submission expands upon and supplements my oral comments during the March 4, 2021 listening session.[[1]](#footnote-1)

By way of context, I am a Professor of Law, and hold the Louis and Hermione Brown chair in preventive law at California Western School of Law, where I also serve as Associate Dean for Assessment and Teaching. I joined the faculty in 2008. My teaching responsibilities include a course I designed studying the law surrounding natural disasters, including some focus on the impact of natural disasters on insured, mortgaged homes. This also has been a focus of my scholarly research, which includes the following published, forthcoming, or in-progress articles and book chapters:

* Kenneth S. Klein, *Homeowner Underinsurance and Mathematical Fallacy* (in progress).
* Kenneth S. Klein, “The Prevalence, Causes, and Depth of Underinsurance for Fire, and What Can Be Done to Remedy It”, in *Climate, Society and Elemental Insurance*, Kate Booth, Chloe Lucas and Shaun French, editors (Rutledge 2021) (forthcoming).
* Kenneth S. Klein, *Ashes to Ashes: A Way Home for Climate Change Survivors*, 63 Ariz. L. Rev. \_\_\_(2021) (forthcoming).
* Kenneth S. Klein, *Minding the Protection Gap: Resolving Pervasive, Profound, Unintended Homeowner Underinsurance*, 25 Conn. Ins. L.J. 34 (2019).
* Kenneth S. Klein, *When Enough Is Not Enough: Correcting Market Inefficiencies in The Purchase And Sale Of Residential Property Insurance*, 18 Va. J. Soc. Pol’y & Law 345 (2011).
* Kenneth S. Klein, *Following the Money – the Chaotic Kerfuffle Over Residential Insurance Proceeds that Simultaneously are the Only Rebuild Funds and the Only Mortgage Collateral*, 46 Cal. W. L. Rev. 305 (2010).

As a selected Consumer Representative to the National Association of Insurance Commissioners, I have presented on insurance and natural disasters. At the invitation of HopeNow, an organization of mortgage servicers/lenders, I have presented on the same topic, as well as on the topic of mortgages and natural disasters. Before joining academia, I was a business litigation attorney and a partner in the national law firm, Foley & Lardner. Both at Foley and elsewhere during my 20+ years as a business litigation defense attorney, I sometimes represented insurers and/or mortgage servicers/lenders. In 2003, while still working as a lawyer, I lost my own home to wildfire (Cedar Fire, San Diego). In the wake of that experience, I became aware of the organization, United Policyholders (UP), which I consider perhaps the most knowledgeable source of information on the impacts of natural disasters on homeowners. Through UP, as well as on my own volition, I now have personally worked with (*pro bono*) hundreds of homeowners who have lost their homes to natural disaster, primarily helping them understand and navigate insurance and mortgage issues. The content of this submission is entirely on my own behalf.

Broadly speaking, my input to FHFA focuses on two challenges to homeowners trying to get back home after a natural disaster: time and money. This is not to derogate the other challenges a homeowner faces, such as emotional, physical, and social challenges. But these other challenges go beyond the focus of these submitted remarks. I offer for your consideration four specific ways that FHFA can ameliorate some of the time and money challenges homeowners often encounter:

1. Prohibiting insurance coverage time limits that prevent homeowners from getting *all* contracted for money.
2. Removing the leeway mortgage lenders/servicers have under mortgages to not require insurance for flood or earthquake or other hazards.
3. Mandating that insurers of mortgaged property—who control and deploy the algorithms used to estimate the coverage adequate to secure the collateral (rebuild a home destroyed by natural disaster)—bear the responsibility for error.
4. Give guidelines to mortgage lenders/servicers to minimize the disruption on the rebuilding process caused by the mortgage lender/servicer holding the insurance proceeds.

 Adopting these proposals will reduce mortgage defaults and increase the frequency of climate change survivors getting back home.

1. **PROPOSAL: Require mortgage-compliant insurance to provide that when a home is destroyed by natural disaster, there is no time limit to collect insurance proceeds so long as the homeowner is acting in good faith to rebuild** **the home.**

Insurance coverages often expire sooner than a homeowner is able to rebuild and re-occupy their home. When this happens, homeowners have less money to rebuild, which necessarily implicates mortgage default rates. My first proposal is that FHFA ameliorate this problem by revising the text of numbered Covenant 5 of the Security Instrument (sometimes referred to as Standard Covenant 5 of the Deed of Trust). Each of the State-specific templates for FannieMae/FreddieMac compliant mortgages[[2]](#footnote-2) should provide that mortgage compliant insurance policies cannot have a time limit to recover policy benefits if the mortgaged dwelling suffers a loss from a state or federally declared emergency, and if the borrower is proceeding in good faith to rebuild/repair/replace the mortgaged property. I further propose FHFA direct mortgage lenders/servicers that as to existing Security Instruments, this standard shall be applied to annual renewals of insurance.[[3]](#footnote-3)

It helps to understand this proposal by concentrating on two, large-dollar coverages in a typical homeowner hazard insurance policy.[[4]](#footnote-4) In addition to coverage for the repair or rebuilding of a lost or damaged home (typically denominated, “Coverage A – Dwelling”), a homeowner hazard insurance policy typically provides coverage for Additional Living Expenses (ALE), sometimes called Loss of Use (LOU) coverage.[[5]](#footnote-5) This is coverage for the costs a homeowner is incurring while unable to occupy the insured home due to a covered loss. If a mortgaged home burns to the ground in a wildfire, for example, then the homeowner still owes the mortgage and any other continuing expenses associated with the lost home, but the homeowner also incurs extra expenses, such as rent to temporarily live somewhere else. If the home is insured and the insurance policy provides ALE coverage, then the insurance does not cover the continuing pre-existing expenses such as mortgage payments but does cover the new, temporary expenses such as rent. ALE coverage often has both a dollar limit (almost always calculated as a percentage of Coverage A – Dwelling) and a time limit. The time limit typically is one year from date of loss, although some states may extend the time limit if the loss occurs in a declared emergency (California, for example, extends ALE time limits to two years, and to three years if the homeowner is proceeding in good faith).[[6]](#footnote-6)

A homeowner hazard insurance policy also typically provides coverage for all the things the homeowner owns and keeps inside their house—clothes, furniture, everything in the kitchen and the garage and the cabinets, electronics, etc. This often is called “Coverage C – Personal Property.”[[7]](#footnote-7) As an enhancement of Coverage C, many insurers offer so-called “replacement cost coverage” for personal property loss. The mechanics of replacement cost coverage is easiest illustrated by example: Assume that a homeowner bought a sofa for $1000 that was lost in a wildfire ten years later. On the date of loss, the depreciated value of that ten-year old sofa was $200. But to replace it with a similar, new sofa would cost $1500. Replacement cost coverage for personal property would pay the homeowner $200 if the homeowner did not replace the sofa but would reimburse the homeowner $1500 if the homeowner did replace the sofa (and that is what the homeowner actually spent to do so). Coverage C--like ALE--usually has both a dollar limit (almost always calculated as a percentage of Coverage A – Dwelling) and a time limit. The time limit typically is one year from date of loss, although again some states may extend it by statute or regulation if the loss occurs in a declared emergency.

One other word about Personal Property Coverage bears mention. Insurers adjusting Coverage C claims often require the insured homeowner to provide a detailed inventory of each lost item, including its original cost (evidenced by receipts that the homeowner is unlikely to have) and a calculation of its depreciated value, based upon age and condition. For homeowners with replacement cost coverage, the inventory also will require a receipt for the purchase of any replacement personal property (in other words, insurers will not pay for replacement in advance, but only post- purchase). It is almost impossible for a homeowner ever to provide an actually complete and accurate inventory. It is exceptionally time-consuming to generate an even largely complete inventory. And it is a highly emotionally fraught enterprise, as it requires a victim to constantly focus on their loss. Twelve months after the 2011 Central Texas wildfire, 80% of surveyed homeowners reported they did not have enough insurance money to replace their belongings (the average amount they fell short was $97,000).[[8]](#footnote-8) Twelve months after the 2012 Colorado wildfire, it was 55% of homeowners by an average of $94,000.[[9]](#footnote-9)

As I hope this brief overview illustrates, for a homeowner who has suffered a total loss in a natural disaster, obtaining their full monetary coverage either under ALE or Coverage C frequently can take a very long time, far longer than the time limit on coverages. A homeowner’s need for ALE coverage lasts as long as it takes to have the lost home rebuilt and occupied. Yet a United Policyholders survey of survivors of the 2010 Fourmile Canyon wildfire 12 months after the event found, for example, that 35% of respondents would run out of ALE benefits before they rebuilt or replaced their home.[[10]](#footnote-10) Twelve months after the 2012 Colorado wildfire, it was 47%.[[11]](#footnote-11) Two years after the 2017 North Bay wildfires, it was 43%.[[12]](#footnote-12) In sum, a homeowner needs ALE for however long it takes to rebuild their home, and often the policy does not allow this.

The same is true with Coverage C. A homeowner cannot pick, purchase, and take delivery of their new sofa, for example, until the homeowner knows the dimensions and finishes of the room that sofa will go in and the house is sufficiently complete so that the sofa can be put in it. And with Coverage C, there is another time dynamic at play. A homeowner will not begin to fully collect Coverage C until the homeowner understands how replacement cost coverage and/or depreciation works.[[13]](#footnote-13) That often does not happen within one year. A United Policyholders survey of survivors of the 2010 San Bruno gas explosion 12 months after the event found, for example, that 39% of respondents reported that their insurance company still had not fully explained how to collect full replacement cost benefits for depreciated items.[[14]](#footnote-14) Twelve months after the 2011 Central Texas wildfire, one-third of respondents said their insurance company had not explained depreciation and how to collect full replacement costs.[[15]](#footnote-15) Twelve months after the 2013 Black Forest wildfire, 70% of surveyed homeowners responded that their insurers had required them to list and describe every single item that was damaged or destroyed.[[16]](#footnote-16) Looking at the same question from the other side of the coin, two years after the 2017 North Bay wildfires, 25% of homeowners responded that their insurers did not require an itemized inventory (suggesting, of course, that 75% *did*).[[17]](#footnote-17) Perhaps most striking, when 12 months after the 2018 Camp Fire, 39% of homeowners responded that their insurers did not require an itemized inventory (implying 61% still did), United Policyholders described this as “really good news.”[[18]](#footnote-18) And it surely was. But we are far from a preferred state of affairs when it is cause for celebration that the number of homeowners still required to do an itemized inventory after a mass fire or flood event has nosed slightly under two-thirds.[[19]](#footnote-19)

With all of this in mind, I turn now to how long rebuilding takes. In the context of natural disasters, a homeowner completing construction often takes far longer than one year. In my oral remarks, I relayed to you the anecdotal perception of one of the Executives of United Policyholders that on average often it takes a homeowner 3, 4, or 5 years to rebuild after a natural disaster. I am not aware of reported data precisely quantifying average time to rebuild a home. But I can give you the results of the homeowner surveys of United Policyholders[[20]](#footnote-20) that would lead one to conclude that a 3-year estimate could be in the ballpark (keeping in mind that as an average, it means for many homeowners it takes longer):

* Two years after the 2007 Southern California wildfires, 47% of respondents had not yet settled with their insurer or their settlement was not enough to rebuild their home (the average amount by which people reported being underinsured was $319,500);
* 12 months after the San Bruno gas explosion 45% of respondents had not reached a settlement with their insurance company on the dwelling portion of their claim (and 50% of respondents reported being underinsured on their dwelling by an average of over $200,000);
* 12 months after the Fourmile Canyon wildfire 36% of respondents had not reached a settlement with their insurance company on the dwelling portion of their claim (and 64% of respondents reported being underinsured on their dwelling by an average of over $200,000);
* 12 months after the 2013 Black Forest wildfire, 57% of homeowners had not reached a settlement, and 46% were did not have enough insurance (at least yet) to rebuild or replace or repair the lost home, and 47% said they lacked sufficient insurance to repair, replace, or rebuild their home; and,
* Two years after the 2017 North Bay wildfires, 33% of homeowners had not yet settled the dwelling portion of their claim (and 64% of respondents reported being underinsured on their dwelling by an average of over $367,000).

The point is simple. If coverages close before the homeowner has rebuilt their home and while monetary coverage limits have not yet been reached, then expenses that the homeowner continues to incur and that would have—but for timing—been covered by the insurer, must come out of the homeowner’s pocket. And that erodes the ability to rebuild, especially because many homeowners already have inadequate Coverage A insurance proceeds to rebuild the mortgaged property. I can tell you both from my own personal experience rebuilding my own home and from my experience working with many homeowners,that frequently homeowners partially fund their rebuilds by diverting Coverage C money to Coverage A needs. If adjusting my Coverage C had been truncated by time, that would have made things worse. Which is another way of saying that time-limiting coverages inevitably will result in more mortgage defaults.

FHFA can ameliorate this mechanism of mortgage defaults by modifying the language of the template for FannieMae/FreddieMac mortgages. The requirement that a single-family residence have property insurance is found in numbered Covenant 5 of the Standard Covenants of a FannieMae/FreddieMac template Security Instrument. Covenant 5 has some variation state-by-state, but for purposes of this proposal the language is ubiquitous. The template for a FannieMae mortgage in Florida, just to pick an exemplar, requires a single-family dwelling to be “insured against loss by fire, hazards included within the term ‘extended coverage,’ and any other hazards including, but not limited to, earthquakes and floods, for which Lender requires insurance” (I believe that nowhere else in the document is the term “extended coverage” defined or even used—this arguably is a problem in and of itself). This language is didnetical, to the best of my knowledge, in FannieMae/FreddieMac mortgages everywhere in the Nation.

The template Security Instruments are silent about whether mortgage compliant insurance can impose a time limit for adjusting claims under Coverage C or ALE or under any other coverage. But, to the best of my knowledge, there is nothing that requires this silence. FHMA could modify the terms of Covenant 5 and could do so nationwide. The language could provide a time limit—for example, three years—that mortgage compliant insurance must leave all coverages open if the mortgaged dwelling suffered a loss from a state or federally declared emergency. Alternatively, Covenant 5 could provide that mortgage compliant insurance could not have a time limit to coverages if the mortgaged dwelling suffered a loss from a state or federally declared emergency, and if the borrower was proceeding in good faith to rebuild/repair/replace the mortgaged property.

Either revision would, for the reasons described above, reduce some incidences of default. While in my oral comments to FHFA I described the former, upon further reflection I now advocate for the latter. There is not a one size fits all timeline for recovery from natural disaster. Among the many variables are the number of homes simultaneously destroyed, and the capacity of the construction market in the locale at the time of loss. Insurers could still protect themselves by having monetary coverage limits.

What would be the consequence of this proposal? Homeowners would have more coverage proceeds to fund recovery. There would be a reduction in mortgage defaults. And there would be more insurers both paying up to full coverage limits and holding more money in reserve rather than generating investment return. I do not find compelling the argument that an insurer having to fully pay the coverage the insurer contracted for and collected premium for is unfair—in these circumstances it simply is occurring for reasons completely outside of the homeowner’s control. And, by contrast, the timelines are actually somewhat in the insurer’s control. As the United Policyholders surveys describe, many homeowners report that insurers create delays that impair reconstruction.[[21]](#footnote-21) Without belaboring the point, consider the responses of homeowners twelve months after the 2017 North Bay wildfires:

* 34% of survey respondents reported experiencing delays in communication with their insurer such as getting answers to questions and return phone calls and emails.
* 30% of survey respondents reported delays in payment of benefits.
* 31% of survey respondents reported receiving a “lowball” settlement offer.[[22]](#footnote-22)

So, tallying up the pros and cons of the proposal that Covenant 5 require that mortgage compliant insurance have no time limit to coverages if the mortgaged dwelling suffered a loss from a state or federally declared emergency (and if the borrower was proceeding in good faith to rebuild/repair/replace the mortgaged property): On one side of the balance are three consequences: reducing defaults, increasing the number of homeowners who are able to return home, and removing an incentive for insurers to delay adjusting claims. On the other side of the balance are insurer profits for extra-insurance reasons. This does not seem to me to be a close question.

1. **PROPOSAL: Delete the text, “for which Lender requires insurance” from the sentence in Covenant 5 of the template FannieMae/FreddieMac Security Instrument requiring the mortgaged property be “insured against loss by fire, hazards included within the term ‘extended coverage,’ and any other hazards including, but not limited to, earthquakes and floods, for which Lender requires insurance.”**

This proposal is to remove the discretion of mortgage lenders to not require mortgaged properties to be insured for floods and earthquakes. Lenders now ubiquitously exercise that discretion—most homes do not have flood or earthquake insurance.[[23]](#footnote-23) Yet flood is the leading cause of homes lost to natural disaster. FHFA should require that all mortgage compliant insurance cover floods and earthquakes.[[24]](#footnote-24) Many of the proposals you will receive in response to your “Request for Input”—including most of my proposals—will suggest small things FHFA can do to make things marginally better. This proposal could do something more profound.

Flooding is “the most common, destructive, and costly form of natural catastrophe in the United States.”[[25]](#footnote-25) Through 2019, eight of the ten costliest disasters on record have been hurricanes, with the other two being the September 11, 2001 terrorist attacks (not a natural disaster) and the 1994 Northridge, California earthquake.[[26]](#footnote-26) “One of HUD’s largest potential liabilities is the mortgages insured through FHA, which includes over $1.26 trillion in mortgage debt on 8 million homes.”[[27]](#footnote-27)

And it’s getting worse. According to the Insurance Information Institute, “Insured losses from hurricanes rose in the past 15 years as hurricane activity has intensified. When adjusted for inflation and after losses are tallied for the 2017 and 2018 hurricanes, nine of the 10 costliest hurricanes in U.S. history have struck since 2004. In addition to the increase in storm activity, construction along both the Gulf Coast and East Coast has continued to develop, and property values have increased, resulting in higher loss exposure.”[[28]](#footnote-28)

Yet, lenders almost never require flood to be an insured loss to a mortgaged dwelling. Only 13-15% of owner-occupied homes are insured for flood.[[29]](#footnote-29) Forty percent of homes insured for flood are required to have flood insurance because the home is located in a designated Special Flood Hazard Area.[[30]](#footnote-30) Meaning only 5-6% of owner-occupied homes are required to insure for flood.

Put another way, absent being required to purchase flood insurance, homeowners simply do not buy it. The other side of the coin of calculating the portion of homeowners who have flood insurance because they are required to have it is that voluntary take-up of flood insurance is below 10%. Which is why the vast majority of mortgaged properties in the United States do not have flood protection. Plainly, mortgage lenders/servicers are not requiring flood insurance.

In addition to the lack of mortgaged housing stock having flood insurance, mortgage lenders/servicers opting out of requiring flood protection creates other problems for the federal government. Among the minority of homeowners who do have flood insurance, there is not a robust private insurance market for flood. The Insurance Information Institute reports that when homeowners have to go outside their hazard insurance and purchase flood insurance *ala carte*: “flood coverage is available as a separate policy from the National Flood Insurance Program (NFIP), administered by the Federal Emergency Management Agency (FEMA), and from many private insurers.”[[31]](#footnote-31) The reality is bleaker. Flood insurance overwhelmingly is through the NFIP; for example, in the United States in 2018 there were 5,037,266 total NFIP policies (either directly written or under a private insurer’s name) representing $1.327 trillion of insurance in force, while by contrast the total of direct written premiums for *all* private insurers that year was $540,875.[[32]](#footnote-32) If the current market would support ubiquitous private flood insurance then you would see it. You don’t. I assume FHFA already knows the problems of NFIP.

The situation with earthquake insurance is no better.[[33]](#footnote-33) Earthquake insurance is almost never mandated.[[34]](#footnote-34) Essentially, the escape hatch, dependent clause of Covenant 5 allowing lenders to not require earthquake insurance is opened (or at least not closed) 100% of the time. Even in California, the CEO of the California Earthquake Authority is quoted as saying only 10% of Californians have earthquake insurance.[[35]](#footnote-35) Nationally the figure is 7%-8%.[[36]](#footnote-36) And again, in any material sense all of it is public insurance of last resort.

It perhaps bears mention that this resistance to voluntarily insure for natural disaster, even in disaster-prone areas, may be part of the American psyche. A recent paper published in the *Journal of Insurance Regulation* examined “reasons why take-up rates for earthquake insurance are significantly higher in the Lower Mainland of British Columbia than in western Washington state even though earthquake risk is largely the same.”[[37]](#footnote-37) The researchers concluded that the explanation was not price, nor policy design, nor demographics of socioeconomics, but rather “we suspect it is a combination of the expectation of post-disaster relief funding and that Washingtonians tend not to purchase earthquake cover largely due to issues related to culture. (Simply, Americans are fundamentally different from Canadians and that the former do not relish being told what to do by authorities.)”[[38]](#footnote-38)

What is the consequence of mortgaged homes not having flood or earthquake insurance? Consider the example from the recent flooding in Nashville, Tennessee as reported in the *Nashville Tennessean*:

Standard homeowner's insurance does not cover losses due to flood damage. Flood coverage must be purchased separately through the National Flood Insurance Program.

"Unfortunately, a lot of renters, a lot of homeowners assume that they are fully protected for all losses, but flood is always a separate coverage — it's always a separate policy," Mark Friedlander, spokesperson for the Insurance Information Institute, said.

In Tennessee, just 2% of homeowners have NFIP policies, according to the Insurance Information Institute. The greater Nashville area fares slightly better: 4.2% of homeowners in Davidson County carry NFIP policies, and 4.4% carry flood insurance in Williamson and Wilson counties.

"More than 95% of homeowners in the greater Nashville area do not have flood coverage," Friedlander said. Nationally, about 85% of U.S. homeowners are not protected against flood damage, though about 90% of natural disasters in the country involve flooding.

"As we just saw in Nashville, flooding can occur just about any place, any time," Friedlander said.

Flood risks have increased in the decade since the 2010 flood, but while Metro Water Services saw flood insurance policies in the county rise to about 7,000 following the flood, that number has now fallen to around 4,000, according to MWS Assistant Director of Storm Water Tom Palko.[[39]](#footnote-39)

The bottom line: Most flood victims in Nashville are going to have a very hard time rebuilding. Those who do have flood insurance are going to see their rates rise. And, although the newspaper article did not discuss it, this experience is unlikely to cause a significant uptick in the take-up rates of flood insurance; rather, research finds that even after a major flood, voluntary take-up rates of flood insurance only increase by 1.5%.[[40]](#footnote-40) In other words, there will be defaults and the next time it floods in Nashville it likely will not be any better.

There is nothing to suggest Nashville’s experience is atypical. All of the above-described data suggests the opposite—Nashville’s experience is emblematic of a Nationwide protection gap of flood and earthquake exposure. At more than one of the NAIC National Meetings I have attended, FEMA representatives have said some version of, “if you live where it rains then you need flood insurance; and it rains everywhere.” Or as the Insurance Information Institute spokesperson in theNashville article was quoted as saying, "flooding can occur just about any place, any time."

There is no debate over the endpoint of a solution to this problem. The endpoint is so-called “All Perils” insurance. Or put another way, standard hazard insurance (typically through a form HO-3) that does not exclude flood or earthquake. Indeed, in just the last three years, “All Perils” as the way to resolve the protection gap of natural catastrophes is the subject of several scholarly articles. It is the subject of my forthcoming paper in the *Arizona Law Review*.[[41]](#footnote-41) Law professor Christopher French wrote on it just last year.[[42]](#footnote-42) Howard Kunreuther, perhaps the world’s pre-eminent economist studying homeowner insurance, wrote on it in 2018.[[43]](#footnote-43)

All of which begs the question, why *aren’t* lenders already exercising the authority Covenant 5 gives to require All Perils insurance? Lenders perhaps are not requiring All Perils at least in part due to an assumption that the insurer is the entity paying the most attention to the adequacy of insurance, and so the lender doesn’t really have to do so. As I described in my paper published in the *Connecticut Insurance Law Journal*, in a home purchase mortgage brokers/lenders typically just assume the insurer is being attentive to the adequacy of insurance.[[44]](#footnote-44) This is not in any way meant as a criticism of the rigor of mortgage lenders/brokers in the United States. My forthcoming book chapter compares the practices of Australia and the United States in responding to natural disasters. In the course of writing that chapter I learned that in Australia after the home purchase is completed, lenders often do not even monitor whether insurance remains in place (and there is not a force placed insurance mechanism in the typical mortgage).

Another factor leading to mortgage lenders not requiring insurance for flood and earthquake may be that it could put a mortgage lender in a competitively disadvantageous position. If All Perils is not the standard, then All Perils will cost more than insurance covering just fire and wind, not also flood and earthquake. Which means that both for an insurer and a lender, as long as peril coverage can be purchased *ala carte*, either All Perils coverage or a loan requiring All Perils coverage is more expensive. That puts a putative lender in a competitively disadvantageous position vis-à-vis other lenders. Which, of course, incentivizes a lender with an option to not require All Perils coverage to not require All Perils coverage.

This is why FHFA should require it. From 2011-2018, 59%-66% of homes had a mortgage or line of credit (averaging 63% without a steady trend equivalent to that of I.I.I. calculations of take-up rates of insurance).[[45]](#footnote-45) Which means if Covenant 5 was modified to require, in essence, “All Perils” insurance, then roughly *two-thirds* of owner-occupied homes in the United States would be required to have flood insurance. And earthquake insurance.

And if FHFA were to do so, the consequence would be even more broad reaching. Over ninety percent of American homeowners have basic homeowner hazard insurance. The public-facing data of the Insurance Information Institute reports that 95% of owner-occupied homes have homeowner insurance.[[46]](#footnote-46) Internally, the research group of I.I.I. reports that in the fall of 2018, 91% of homeowners said they had homeowner insurance, down slightly from 93% in 2016, trending down since 2011, when the figure was 97%.[[47]](#footnote-47)

The common explanation for the dramatically higher take-up rates of standard hazard insurance is that FNMA and FHLMC compliant mortgages require standard homeowner insurance.[[48]](#footnote-48) But from 2011-2018, on average only 63% of homes had a mortgage or line of credit, while over 90% have standard hazard insurance. If one crunches more precise numbers, then the conclusion is 73.5%-87.8% of homes without a mortgage--homeowners in the U.S. who have a choice--still choose to have standard hazard insurance.

Why is there such high voluntary take-up rates of standard homeowner insurance among the roughly one-third of homes in the United States that do not have a mortgage? One explanation suggested by the data is from the most recent American Housing Survey of the U.S. Census Bureau--as of 2017, only 8.5% of owner-occupied homes were purchased outright, suggesting 91.5% of homes initially were purchased with some sort of mortgage.[[49]](#footnote-49) That is a notably similar percentage to the percentage of total homeowners with hazard insurance. In other words, forcing a new home buyer to buy insurance may become habit-forming. Or perhaps insurance that appears too expensive if one has a choice becomes revealed as a good buy from the experience of being required to buy it. Either way, it means that if mortgage compliant insurance did not exclude flood or earthquake, then with the stroke of a pen perhaps ninety percent or more of owner-occupied homes in the United States would, over time, be insured for fire AND flood AND earthquake.

The point merits no further exploration for FHFA’s purposes. The ultimate proof is in the results—the vast majority of homes do *not* have insurance either for flood or earthquake. Plainly, mortgage lenders are not requiring it. FHMA has the power to change this state of affairs. The key is to disallow mortgage compliant insurance exclusion of flood or earthquake. Doing so would lead to 90%+ of owner-occupied homes in the United States having fire, wind, flood, and earthquake protection. And a knock-on benefit would be to create a robust private market for “All Perils.”

This would dramatically change the insurance markets, and so should not be done without further opportunity for notice and comment. That said, I do not expect significant opposition. I expect this proposal would be supported by mortgage lenders and servicers for obvious reasons—more protection of collateral. It may be a more complex analysis for insurers and homeowners, but I believe it is good for both of these constituencies as well. In this regard, my thinking is captured in my forthcoming paper in the *Arizona Law Review*. A draft of the paper can be found at: [https://ssrn.com/abstract=3793869](https://ssrn.com/abstract%3D3793869). For the reasons explained in that paper, I believe more homeowners will have full or near full coverage for flood and earthquake (at present, NFIP coverage for dwellings is limited to $250,000), at an affordable price. And insurers will have more profitably covered risk. Essentially, FHFA would create a marketplace in All Perils insurance that a private insurer could compete and succeed in, and homeowners would purchase.

As with my prior proposal, this proposal can be made comprehensively by FHFA directing mortgage servicers to implement it upon the renewal of existing homeowner insurance.

I offer one further observation before turning to my next proposal—anything that increases the cost of insurance, even just somewhat and less than dramatically, likely will have disparate impact demographically and socioeconomically. This seems to be the consensus thread of researchers on financial systems and social justice. It needs to always be in the forefront of law and policy choices. I simply am of the view that this is best addressed by government public policy decisions on vouchers or subsidies in combination with oversight, as opposed to distorting the soundness of lending or the actuarially accuracy of pricing risk.

1. **PROPOSAL: Mortgage compliant insurance must be adequate to fully rebuild a home, meaning at or exceeding the amount the insurer estimates as adequate, and the insurance policy must provide that if the insurance is in this amount and the coverage is inadequate by more than 5%, then the insurer must fully pay for the reconstruction of the dwelling without regard to stated coverage limits.**

My third proposal is that Covenant 5 should provide that mortgage compliant insurance must have Coverage A in at least the amount of an insurer-provided estimate of full reconstruction costs. And the insurer has to bear the cost of any error of greater than 5%.

The purpose of this proposal is to reduce the incidence of underinsurance—also known as the protection gap—by which I mean when the insurance proceeds available to rebuild a lost home are less than the actual cost to rebuild the lost home. There is not yet precise data, but it appears that even before disaster strikes, roughly 60% or more of homeowners are unintentionally and unknowingly underinsured by at least 20%, often more.[[50]](#footnote-50) In the wake of a home lost to natural disaster, this by definition will implicate default rates of mortgaged homes lost to natural disaster.

This subject—the causes and solutions to underinsurance—has been a subject of both my past research and my current research. It is a devilishly tricky challenge and cannot be resolved nor even explained in the confines of a letter such as this one. The detail underneath everything that follows can be found in my research papers. I can summarize it as follows:

In the wake of every natural disaster, scores of homeowners find their available insurance coverage is inadequate.[[51]](#footnote-51) Three explanations commonly are offered—homeowners who did not want to purchase full insurance coverage; demand surge pricing post-disaster; or that something is broken in the way that insurers estimate full replacement costs. The data suggests that the third of these is the predominant factor. It is the one that this proposal would ameliorate.

Most homeowners actually want to be fully insured. This is the implication of work done by Professors Benjamin Collier and Marc Ragin.[[52]](#footnote-52) In a 2017 study of homeowners required to purchase flood insurance, Professors Collier and Ragin documented that given the choice between less than full, full, or more than full replacement cost coverage limits, only 20.45% of homeowners opted for less than full coverage limits.[[53]](#footnote-53) These figures are in harmony generally with what the Insurance Information Institute found in its 2020 Consumer Poll on what insurance homeowners want and think they have.[[54]](#footnote-54) I am unaware of any contrary research.

While post-disaster demand surge surely occurs, it also does not seem to explain to prevalence and depth of underinsurance. Demand surge does not seem to be a factor that swamps normal construction costs; I am aware of only one real-world study seeking to quantify the inflationary impact of demand surge—that study found that demand surge caused construction prices to rise by 15-30% (and was done by an insurance industry-affiliated entity).[[55]](#footnote-55)

If this is the impact of demand surge, then even if demand surge is not accounted for by the replacement cost estimates insurers provide to insureds in order to inform adequacy of coverage, demand surge should be accounted for by a homeowner who purchases extended replacement coverage. As *Forbes* very recently explained, “Some (but not all) home insurance companies offer extended replacement cost. This feature can provide anywhere from 10% to 50%—or more—of extra coverage to absorb a cost spike.”[[56]](#footnote-56) Or as California explains (through section 10102 of the California Insurance Code, this explanation should be part of every homeowner hazard insurance policy), “After a widespread disaster, the cost of construction can increase dramatically as a result of the unusually high demand for contractors, building supplies, and construction labor. This effect is known as demand surge. Demand surge can increase the cost of rebuilding your home. Consider increasing your coverage limits or purchasing Extended Replacement Cost coverage to prepare for this possibility.” Yet, as a Market Conduct Study by the California Department of Insurance found after the 2007 wildfire season, “[e]ven when the homeowner had purchased extended replacement cost coverage, 57 percent of these policies still underinsured their policyholders relative to the cost of rebuilding their homes.”[[57]](#footnote-57)

Add all this data up and the conclusion suggested is that nether homeowner choice, demand surge, nor the combination of the two is the dominant explanation of underinsurance. Which leaves insurers’ method of estimating replacement costs.

Not all homeowner insurance is replacement cost coverage (coverage estimated as adequate to rebuild a lost home, as opposed to compensating the depreciated value of the dwelling on date of loss). But most is. And frankly, if FHFA is concerned with a homeowner being able to restore the collateral, move home, and not default, then FHFA should require that mortgage compliant insurance be replacement cost coverage.

In theory, a homeowner can purchase Guaranteed Replacement Cost coverage, meaning that there is no monetary coverage limit to Coverage A. But in reality, most of the time there will be a monetary coverage limit, meaning the coverage will be styled as Full Replacement Cost, and it will provide coverage up to that limit.

How is that limit decided upon? Again, in theory, it is whatever the homeowner decides upon. But insurers are suspicious of homeowners who seem to be trying to over-insure. And homeowners generally only are familiar with what they paid for their home, which is a vastly different figure than what it would cost to rebuild their home. So, evry insurance industry insider—including insurers and departments of insurance--tell homeowners to ask someone in the insurance business. For example, the Insurance Information Institute tells homeowners, “... your insurer will provide a recommended coverage limit for the structure of your home....”[[58]](#footnote-58) The National Association of Insurance Commissioners tells homeowners, “Your insurance agent usually will help you decide how much dwelling coverage to buy when you first get homeowners insurance. Your coverage should equal the full replacement cost of your home.”[[59]](#footnote-59) The Texas Department of Insurance tells homeowners, “Ask your insurance company if you aren’t sure how much it would cost to rebuild your home.... “[[60]](#footnote-60) The North Caroline Department of Insurance tells homeowners, “You should also discuss your insurance needs with an insurance agent. It is this person’s job to help you choose the right type and amount of insurance.”[[61]](#footnote-61) When homeowners follow this consensus advice, the insurer’s estimate becomes the monetary coverage limit of Coverage A.

That is not the problem. The problem is that there is a perverse and counter-intuitive set of incentives and estimating challenges that bias the estimate low.[[62]](#footnote-62) And worse still, insurers operate within a set of market incentives that give them little reason to do anything about it. Rather, the legal landscape (court decisions) that insurers operate within rewards insurers who assert that homeowners bear the responsibility (the cost) of inadequate Coverage A.

Changing this legal landscape would be a long and uncertain enterprise. But FHFA, again, can change it with the stroke of a pen. Covenant 5 could be revised to reconnect risk and responsibility. The revision would be to provide that mortgage compliant insurance must:

* Provide either Guaranteed Replacement Coverage or Full Replacement Coverage.
* Require that if a homeowner opts for Full Replacement Coverage, then the insurer must provide the homeowner an estimate of full replacement cost in the event of a total loss, and the amount of Coverage A must be at or exceed that estimate.
* Require that if a homeowner opts for Full Replacement Coverage, then the insurance contains a clause whereby the insurer agrees that should a covered loss occur to the dwelling and the coverage limit of Coverage A is inadequate by more than 5%, then the insurer will reform the coverage limit of Coverage A to adjust the homeowner’s claim to pay 100% of the actual reconstruction cost.

I fully expect insurers to robustly oppose this Proposal, as the current state of affairs serves them quite profitably. That is why I have built into this proposal at least a small incentive to do the right thing—if insurers are good at estimating replacement cost of a home, then by estimating into the 5% error margin I propose, the insurer can increase profit.

But, in the end, your Request For Input does not seek proposals that are good for insurers; you seek proposals that are good for homeowners, good for mortgage lenders/servicers, and good for GSEs. And that is this proposal. It will reduce the number of homeowners lacking funds to rebuild. It will increase the incidence of rebuilding of collateral with a new dwelling of like nature, quality, and value. It will reduce defaults.

And this proposal need not be only forward looking into new mortgages. As with my prior proposals, this proposal can be made comprehensively by FHFA directing mortgage servicers to implement it upon the renewal of existing homeowner insurance.

Finally, I recognize that insurers may assert that underwriting natural disaster risk accurately simply can’t be done. If you encounter this assertion, I suggest you test it carefully. I currently have Guaranteed Replacement Coverage. I have had it for over two decades. Clearly it can be done. And if for any particular insurer it can’t be done—its “Full” Replacement Coverage is not full and cannot be full and more often than not is inadequate by a material amount--then that insurer should say that and get out of the business of insuring mortgaged homes. If FHFA requires that the two-thirds of U.S. homes under mortgage are fully insured, then the insurance industry will find a way to insure those homes and do that profitably, even if some individual insurers struggle.

1. **PROPOSAL: FHFA should publish a set of directives to eliminate common practices by mortgage servicers that impair the likelihood of reconstruction of the mortgaged home.**

Finally, I propose a suite of changes to the mechanics of handling the home reconstruction insurance proceeds for a mortgaged property. Mortgage lenders/servicers currently have a lot of leeway under Covenant 5. That leeway leads to a lot of mischief.

To put this in some context, the entire point of Covenant 5 is to protect loan solvency by requiring the loan collateral (the home) is insured, thereby protecting the mortgage lender/servicer if the home is harmed or destroyed. In other words, destruction of the collateral (the home) does not leave the lender unsecured, but rather simply temporarily changes the nature of the security from a house to cash. The mechanism of this alternative security for the loan is that the lender is identified as an additional insured, which in turn means that the insurer is required to distribute the insurance proceeds (“loss drafts”) by checks co-written to both insureds—the homeowner and the mortgage lender/servicer. The homeowner then endorses the check for deposit by the mortgage lender/servicer, which in turn allows the l mortgage lender/servicer to always be fully secured. This intuitively sensible mechanism, however, creates all sorts of financial pressure on the homeowner’s ability to rebuild, and thereby implicates default rates. Of equal gravity (to me), it leads to behaviors that I consider just plain wrong.

An example of typical, pertinent language within Covenant 5 is the FreddieMac template Security Instrument for Pennsylvania:

Unless Lender and Borrower otherwise agree in writing, any insurance proceeds, whether or not the underlying insurance was required by Lender, shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender’s security is not lessened. During such repair and restoration period, Lender shall have the right to hold such insurance proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender’s satisfaction, provided that such inspection shall be undertaken promptly. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such insurance proceeds, Lender shall not be required to pay Borrower any interest or earnings on such proceeds. Fees for public adjusters, or other third parties, retained by Borrower shall not be paid out of the insurance proceeds and shall be the sole obligation of Borrower. If the restoration or repair is not economically feasible or Lender’s security would be lessened, the insurance proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such insurance proceeds shall be applied in the order provided for in Section 2.[[63]](#footnote-63)

There can be some variability in these clauses. Within the template FannieMae Security Instrument for California, for example, there is the clause:

Borrower further agrees to generally assign rights to insurance proceeds to the holder of the Note up to the amount of the outstanding loan balance.[[64]](#footnote-64)

There also can be variability in how mortgage lenders/servicers interpret the leeway, if any, remaining to *the lender/servicer* by the language requiring the homeowner to use insurance proceeds to repair/replace/rebuild. For example, according to one United Policyholders survey, after the 2011 Central Texas wildfire 35% of respondents described that their mortgage servicers/lenders required insurance funds be used to pay down home loans.[[65]](#footnote-65)

But the basics are constant. To the best of my knowledge, my piece in the *California Western Law Review* is the only published research on what happens to insurance proceeds when a mortgaged and insured property is lost in a natural disaster.[[66]](#footnote-66) While in the time since that paper was published, much has changed, there persists a set of choices lenders/servicers make with some frequency when natural disasters destroy a property in the lender’s/servicer/s portfolio. Lenders/servicers take control of all the Coverage A proceeds, sometimes well in excess of the outstanding balance of the loan. Many lenders/servicers will not release funds on a schedule consistent with a homeowner paying a contractor to rebuild the home. Many lenders/servicers pay no interest on the money. Many lenders/servicers do not hold the insurance proceeds in accounts insured against the failure of the financial institution. Some lenders/servicers insist on paying down the existing loan rather than allow the homeowner to rebuild. And many lenders/servicers farm out all handling of the insurance proceeds to third party vendors with no authority to negotiate often arbitrarily pre-determined funds handling rules. Each of these choices creates problems.

As I have described earlier, underinsurance is the norm, not the exception. The consequence is the homeowner has to be flexible and creative to rebuild a home of equal value to the one destroyed. In this environment, every dollar in hand helps. And every dollar not in hand hurts. If lenders/servicers hold funds in excess of the outstanding loan balance, then that hurts. Holding funds in excess of the outstanding loan balance increases the likelihood that the home will not be returned to its pre-loss value. And there is no good reason for lenders/servicers to do this. If lenders/servicers have cash on deposit (and under lender/servicer control) sufficient to the full outstanding balance, then lenders/servicers are fully protected. Worse, Covenant 5 actually requires the borrower to restore the collateral (to rebuild the home to pre-loss value). By holding funds in excess of outstanding loan balances, lenders/servicers arguably are acting in bad faith by forcing borrowers toward breach of the loan agreement.

Now turning to fund control. As described above, post-disaster demand surge is the norm. The reason is that the construction trades and suppliers do not have open capacity/inventory, but rather book/stock to expected, normal, building calendars. If suddenly several hundred unexpected projects simultaneously come online, then prices spike. That is demand surge. Which is another way of saying if your home is one of those several hundred homes the natural disaster destroyed, it is *hard* to find a contractor. And it is nigh on impossible if you cannot pay your contractor on what the contractor considers a normal payment schedule. If lenders/servicers will not release funds on a schedule consistent with a normal payment schedule to pay a contractor to rebuild the home, then the home is less likely to be rebuilt. There will be more defaults. And there will be more plausible claims of bad faith.

Turning to interest, many (perhaps most) lenders/servicers pay no interest on the insurance proceeds in the lender’s/servicer’s control. Nothing in Covenant 5 requires it. Even in California, which has a statute that could be within “Applicable Law” requiring interest,[[67]](#footnote-67) a recent court decision rejects that interpretation.[[68]](#footnote-68) But FHFA *could* require 2% simple interest. And FHFA *should* require 2% simple interest. To the lender/servicer, interest is significantly to the right of the decimal point. But for the homeowner who has literally lost everything--when I lost my home, the first thing I bought the next day was a toothbrush because I no longer owned one--that interest buys a sofa.

Next, there is the matter of insured accounts. Most individuals—if they have savings at all—have savings in FDIC-insured accounts. One might even posit that one point of a financial institution advertising that it has FDIC-insured accounts is to assure folks who might choose that institution as the place to open a savings account. But insurance proceeds arguably are not held in insured accounts. It is a somewhat complex question involving federal pre-emption doctrine and characterization of accounts as ones holding general deposits or special deposits. Lenders/servicers don’t frequently fail. But they could. And homeowners have no say at all at which institution is the servicer of the homeowner’s mortgage—that mortgage has been sliced and diced and servicing obligations potentially transferred perhaps multiple times in the secondary markets. Which all creates risk for the homeowner that the homeowner has zero control over, unless and until FHFA clarifies the nature of the accounts holding insurance proceeds.

Many Security Instruments require the homeowner to rebuild. But the Security Instruments do not require the lenders/servicers to *let* the homeowner rebuild. And many lenders/servicers unilaterally apply insurance proceeds to the loan. Which is a problem. Because typically construction loans are more expensive than mortgage loans.

Finally, there is the issue of a homeowner, when encountering any or all of the above challenges, simply finding someone in the lender/servicer, with authority, to communicate with. It is an unusual and unpredictable event for a lender/servicer to have a homeowner who has lost their home to natural disaster. Lenders/servicers do not anticipate it, do not staff or train for it, and sometimes farm out the funds handling of the “loss drafts” to third parties that are difficult to speak to directly and often have no authority. This may seem like a trivial point but let me assure you it can be huge. It is so, so hard to rebuild when you have lost everything. And it can be an emotional tipping point to a trauma victim to simply never be able to speak to someone directly who has authority to make things a little bit better if they so choose.

I have spoken to scores of homeowners over the years about these loss drafts challenges, and on homeowners’ behalf I have spoken to scores of lenders/servicers. Based on these admittedly anecdotal experiences, I am confident in my conclusion that lenders/servicers are not trying to harm homeowners. This is not a problem born of malice or even of indifference. Rather, it is a problem born of failure of imagination—failure to foresee and plan for an infrequent and unpredictable problem that from the lender’s/servicer’s perspective is of nominal materiality.

The likely triviality of the problem from the lender’s/servicer’s perspective makes the solution so very easy for FHFA. Whether by revisions to Covenant 5, by direction to lenders/servicers, or by a combination of the two, I propose FHFA instruct lenders/servicers to:

* Not hold insurance proceeds in excess of the outstanding balance of the loan.
* Pay interest on held proceeds at the greater of the 2% simple or whatever return the financial institution is making on the funds.
* Fund control release of proceeds on no slower schedule than the same schedule as a construction loan funds would disburse.
* Hold funds in a federally insured account. And structure the accounts that the funds are held in so that the entire balance is insured.
* Confirm that it is the borrowers’ option whether to use the funds to rebuild or to pay off the loan.
* Provide a direct contact with authority within the financial institution rather than through a third-party vendor.

I suspect I have metaphorically overstayed my welcome in responding to FHFA’s Request for Input, and so I will end my input here. Thank you for the opportunity to present oral remarks. Thank you for your consideration of my input.

Sincerely,



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Pronouns: he/him/his

1. <https://www.fhfa.gov/Videos/Pages/FHFA-Public-Listening-Session-on-Climate-and-Natural-Disaster-Risk-Management-at-the-Regulated-Entities.aspx>, 2:20:45-2:28:20. [↑](#footnote-ref-1)
2. *See* <https://singlefamily.fanniemae.com/legal-documents/security-instruments> and https://sf.freddiemac.com/tools-learning/uniform-instruments/all-instruments. [↑](#footnote-ref-2)
3. Roughly five percent of the U.S. housing stock turns over in any given year. As a consequence, changing the covenants of mortgages going forward is a slow fix. On the other hand, Covenant 5 empowers lenders/servicers to change what is mortgage compliant insurance. For example, Covenant 5 of the template Georgia FannieMae Security Instrument provides, in pertinent part, “What Lender requires pursuant to the preceding sentences can change during the term of the Loan.” https://singlefamily.fanniemae.com/legal-documents/security-instruments. [↑](#footnote-ref-3)
4. To confirm what is or is not frequently found in a homeowner insurance policy, I commend the website of the California Department of Insurance, which provides a tool to look at a variety of homeowner insurance coverages. <https://interactive.web.insurance.ca.gov/apex_extprd/f?p=143:16:::NO>:::. [↑](#footnote-ref-4)
5. *See generally* Insurance.com, *How additional living expenses coverage works*, <https://www.insurance.com/home-and-renters-insurance/natural-disasters/additional-living-expenses.html>; Allstate, *What is Additional Living Expense Coverage*, https://www.allstate.com/tr/home-insurance/additional-living-expense-coverage.aspx;United Policyholders, *Survivors Speak: Additional Living Expenses (ALE)/Loss of Use*, https://uphelp.org/claim-guidance-publications/survivors-speak-additional-living-expense-ale-loss-of-use/. [↑](#footnote-ref-5)
6. California Insurance Code section 2060(b)(1). [↑](#footnote-ref-6)
7. *See generally* Allstate, *What Is Personal Property Coverage?*, <https://www.allstate.com/tr/insurance-basics/personal-property-coverage.aspx>; United Policyholders, *A Guide to Your Homeowners Policy*, https://uphelp.org/wp-content/uploads/2020/09/dec\_page\_guide.pdf. [↑](#footnote-ref-7)
8. https://uphelp.org/media/surveys/. [↑](#footnote-ref-8)
9. https://uphelp.org/media/surveys/. [↑](#footnote-ref-9)
10. https://uphelp.org/media/surveys/. [↑](#footnote-ref-10)
11. https://uphelp.org/media/surveys/. [↑](#footnote-ref-11)
12. https://uphelp.org/media/surveys/. [↑](#footnote-ref-12)
13. In this regard, for an insurer (whether acting intentionally or not) time is money. Every dollar a homeowner is entitled to under a coverage but does not collect before time expires is a dollar of profit to an insurer. [↑](#footnote-ref-13)
14. https://uphelp.org/media/surveys/. [↑](#footnote-ref-14)
15. https://uphelp.org/media/surveys/. [↑](#footnote-ref-15)
16. https://uphelp.org/media/surveys/. [↑](#footnote-ref-16)
17. https://uphelp.org/media/surveys/. [↑](#footnote-ref-17)
18. https://uphelp.org/media/surveys/. [↑](#footnote-ref-18)
19. Further, UP anecdotally has observed that while following the Camp Fire many insurers advanced 75% of Coverage C without requiring a detailed inventory, after the 2020 California wildfires insurers often have dropped these advances to 30% of Coverage C. [↑](#footnote-ref-19)
20. https://uphelp.org/media/surveys/. [↑](#footnote-ref-20)
21. <https://uphelp.org/media/surveys/>. [↑](#footnote-ref-21)
22. <https://uphelp.org/media/surveys/>. [↑](#footnote-ref-22)
23. *See* Fed. Ins. Off., U.S. Dep’t of the Treasury, Report Providing an Assessment of the Current State of the Market For Natural Catastrophe Insurance in the United States 15-16 (Sept. 2015). [↑](#footnote-ref-23)
24. Every home in the United States faces idiosyncratic risks—homes in a desert, for example, have slight flood risk, if any. The entire concept of insurance, however, is risk-spreading and risk-sharing. If risk is not covered for homes at low likelihood of incurring that risk, then all sorts of adverse selection problems arise, and insurance prices as high-risk pools. The health insurance markets, pre- the Affordable Care Act, aptly illustrate the mischief that results. Put bluntly, in the United States we are poor at prudently insuring against flood risk. HUD, for example, has found that homes within 600 meters of a Special Flood Hazard Area (meaning homes that are not required to have flood insurance, but are in a flood plain and are within 600 meters of the area requiring homes to have flood insurance) had insurance take-up rates much more similar to homes further away rather than the insurance take-up rates for homes within the SFHA. 2M Research, *Multidisciplinary Research Team: Task Order 7. Flood Insurance Coverage of Federal Housing Administration Single-Family Homes* v-vii, 20-27, 40, U.S. Dept. Housing & Urban Devel., Office Policy Devel. & Research (March 30, 2020). [↑](#footnote-ref-24)
25. Fed. Ins. Off., U.S. Dep’t of the Treasury, Report Providing an Assessment of the Current State of the Market For Natural Catastrophe Insurance in the United States 27 (Sept. 2015). [↑](#footnote-ref-25)
26. Insurance Information Institute, *2020 Insurance Factbook* 146 (2020). [↑](#footnote-ref-26)
27. 2M Research, *Multidisciplinary Research Team: Task Order 7. Flood Insurance Coverage of Federal Housing Administration Single-Family Homes* at i, U.S. Dept. Housing & Urban Devel., Office Policy Devel. & Research (March 30, 2020). [↑](#footnote-ref-27)
28. Insurance Information Institute, *2020 Insurance Factbook* 147 (2020). Hurricane is a mixed wind/flood event. Wind is covered by standard hazard insurance. Flood is not. And flood insurance often is inadequate even when it exists. This is one reason why I.I.I. tracks and is concerned with hurricanes as flood events. [↑](#footnote-ref-28)
29. Insurance Information Institute, *Facts + Statistics: Flood Insurance*, <https://www.iii.org/fact-statistic/facts-statistics-flood-insurance>;Insurance Information Institute, *2016 Consumer Insurance Survey. Homeowners Insurance: Understanding, Attitudes and Shopping Practices* 5 (2017). [↑](#footnote-ref-29)
30. *See* Sarah Strochak, Jun Zhu, & Laurie Goodman, *Too many homeowners lack flood insurance, but many buy it voluntarily*, Urban Wire: Housing and Housing Finance (The blog of the Urban Institute), <https://www.urban.org/urban-wire/too-many-homeowners-lack-flood-insurance-many-buy-it-voluntarily> (2018) (citing the 2017 American Housing Survey) (“Nationally, 40 percent of those who have flood insurance purchased it because it was required and 60 percent purchased it voluntarily.”). [↑](#footnote-ref-30)
31. Insurance Information Institute, *Facts + Statistics: Flood insurance*, https://www.iii.org/fact-statistic/facts-statistics-flood-insurance. [↑](#footnote-ref-31)
32. Insurance Information Institute, *Facts + Statistics: Flood insurance*, <https://www.iii.org/fact-statistic/facts-statistics-flood-insurance#Private%20Flood%20Insurance,%202016-2019> (2020). [↑](#footnote-ref-32)
33. *See generally* Fed. Ins. Off., U.S. Dep’t of the Treasury, Report Providing an Assessment of the Current State of the Market For Natural Catastrophe Insurance in the United States 38 (Sept. 2015). [↑](#footnote-ref-33)
34. Fed. Ins. Off., U.S. Dep’t of the Treasury, Report Providing an Assessment of the Current State of the Market For Natural Catastrophe Insurance in the United States 38 (Sept. 2015), [https://home.treasury.gov/system/files/311/Natural%20Catastrophe%20Report.pdf](https://www.floods.org/ace-files/documentlibrary/NFIP/Current_State_of_the_Market_for_Natural_Catastrophe_Insurance_Dept_of_Treasury_Sept15.pdf) (citing California State Senate Committee on Insurance Informational Hearing, *Catastrophic Risk in California: Are Homeowners and Communities Prepared?* 8 (May 14, 2014), *available at* http://sins.senate.ca.gov/sites/sins.senate.ca.gov/ files/14.05-14.Background.Catastrophic%20Risks%20in%20California.PDF). [↑](#footnote-ref-34)
35. Nick Miler, *Only 10 Percent of California Homes Are Covered By Earthquake Insurance*, <https://www.kvcrnews.org/post/only-10-percent-california-homes-are-covered-earthquake-insurance#stream/0> (2019). [↑](#footnote-ref-35)
36. Fed. Ins. Off., U.S. Dep’t of the Treasury, Report Providing an Assessment of the Current State of the Market For Natural Catastrophe Insurance in the United States 39, fig. 9 (Sept. 2015), [https://home.treasury.gov/system/files/311/Natural%20Catastrophe%20Report.pdf](https://www.floods.org/ace-files/documentlibrary/NFIP/Current_State_of_the_Market_for_Natural_Catastrophe_Insurance_Dept_of_Treasury_Sept15.pdf), Insurance Information Institute, *2016 Consumer Insurance Survey. Homeowners Insurance: Understanding, Attitudes and Shopping Practices* 6 (2017). [↑](#footnote-ref-36)
37. Mary Kelly, Steven Bowen, and R. Glenn McGillivray, *The Earthquake Insurance Protection Gap: A Tale of Two Countries*, 39(11) J. Ins. Reg. 1-37, 1 (2020). [↑](#footnote-ref-37)
38. Because of these findings, the researchers concluded the solution did *not* rest with traditional approaches of price, design, and education, but rather with some other non-traditional approach. *Id.* at 28.These researchers also rejected the approach of making earthquake insurance mandatory because they noted that flood insurance was mandatory and yet the penetration of flood insurance remained “woefully inadequate.” *Ibid.* But, of course, flood insurance in the United States is only mandatory in 5-6% of the owner-occupied housing stock. Or as other recent research concluded, outside of Special Flood Hazard Areas (areas where to get a federally backed mortgage, flood insurance is required), “very few properties have a flood policy, even in areas at risk of flooding.” Carolyn Kousky, Howard Kunreuther, Michael LaCour-Little, and Susan Wachter, *Flood Risk and the U.S. Housing Market*, 29 J. Housing Research S3,S9 (2020). [↑](#footnote-ref-38)
39. Cassandra Stephenson, *Who pays for flood damage? Most Middle Tennesseans don’t have flood insurance.*, Nashville Tennessean (Mar. 30., 2021). [↑](#footnote-ref-39)
40. *Id.* at S10-11. *Accord*, Craig E. Landry, Sarah Anderson, Elena Krasovskaia, and Dylan Turner, *Willingness to Pay for Multi-Peril Hazard Insurance* 21 (2020), https://ssrn.com/abstract=3662668. [↑](#footnote-ref-40)
41. A draft of the paper can be found at: [https://ssrn.com/abstract=3793869](https://ssrn.com/abstract%3D3793869). [↑](#footnote-ref-41)
42. Christopher C. French, *America on Fire: Climate Change, Wildfires & Insuring Natural Catastrophes*, 54 U.C. Davis L. Rev. 817 (2020). [↑](#footnote-ref-42)
43. Howard Kunreuther, *All-Hazards Homeowners Insurance: Challenges and Opportunities*,21 Risk Mng’t. & Ins. Rev. 141 (2018). [↑](#footnote-ref-43)
44. Kenneth S. Klein, *Minding the Protection Gap: Resolving Pervasive, Profound, Unintended Homeowner Underinsurance*, 25 Conn. Ins. L.J. 34, 54 (2019). [↑](#footnote-ref-44)
45. <https://www.census.gov/programs-surveys/ahs/data/interactive/ahstablecreator.html?s_areas=00000&s_year=2011&s_tablename=TABLE14A&s_bygroup1=19&s_bygroup2=1&s_filtergroup1=2&s_filtergroup2=1>; <https://www.census.gov/programs-surveys/ahs/data/interactive/ahstablecreator.html?s_areas=00000&s_year=2013&s_tablename=TABLE14A&s_bygroup1=19&s_bygroup2=1&s_filtergroup1=2&s_filtergroup2=1>; <https://www.census.gov/programs-surveys/ahs/data/interactive/ahstablecreator.html?s_areas=00000&s_year=2015&s_tablename=TABLE14A&s_bygroup1=19&s_bygroup2=1&s_filtergroup1=2&s_filtergroup2=1>; <https://www.census.gov/programs-surveys/ahs/data/interactive/ahstablecreator.html?s_areas=00000&s_year=2017&s_tablename=TABLE14A&s_bygroup1=19&s_bygroup2=1&s_filtergroup1=2&s_filtergroup2=1>. [↑](#footnote-ref-45)
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