National Flood Insurance Program (NFIP)

2017 Reauthorization Priorities – A White Paper

The National Flood Insurance Program (NFIP) was established in 1968 to provide affordable flood insurance when the private market stopped covering flood risk within certain floodplains. All properties within the floodplain that carry federally-backed mortgages are required to have flood insurance. Today, there are 5.1 million policies nationwide, and approximately 1.8 million in Florida.

FEMA began drawing Flood Insurance Rate Maps (FIRMs) in 1975. Properties that were built prior to the drawing of flood maps and to their community's adoption of flood plain regulations are considered Pre-FIRM.

Flood risk in NFIP is borne entirely by the federal government. The program is administered by private "Write-Your-Own" companies that are paid upwards of 30% of the premium for that administration. Coverage is limited to $250,000 per residential structure and $500,000 per commercial structure.

It is unclear how NFIP establishes insurance rates. While the NFIP has divided the floodplain into 30 territories, rates are not promulgated by territory. State regulators have been unable to access actuarial data from NFIP to analyze rate-making and determine whether rates are excessive, inadequate or unfairly discriminatory.

Since 1978, NFIP has generally generated sufficient premiums to pay its claims. It should be noted that NFIP does not retain net profits to offset future losses, nor does it invest any excess premiums or purchase reinsurance. Between 1978 and 2012 the program collected $9 billion in excess of claims paid (adjusted for inflation). This includes 2006 when it was widely reported that Hurricane Katrina resulted in a $24 billion loss to the program (covered by the U.S. Treasury).

NFIP is reauthorized every three years. In 2012, it was reauthorized through the Biggert-Waters Flood Insurance Reform Act which sought to eliminate the NFIP deficit simply by increasing premiums. The result was that many homeowners saw their premiums escalate to unaffordable amounts. In one case, the premium on a $300,000 home increased from $1,900 to over $49,000.

To address this crisis, the Homeowners Flood Insurance Affordability Act was passed in 2014. Through HFIAA, rate increases were capped at no more than 18% annually for residential and 25% for commercial properties. NFIP must be reauthorized in 2017. As a major participant in NFIP, Florida – along with the other Gulf States – must ensure that reauthorization and/or reform addresses issues of importance to our communities.

OVERRIDING POLICY PRINCIPLES

- **NFIP is Important.**

  America's coastal counties are home to 39% of the population, generate 51.6 million jobs and are responsible for 46% of the nation's GDP. Ninety-four percent (94%) of all NFIP policies are in coastal counties. It is vital to the nation's economy that coastal properties can affordably insure against flood loss.

- **NFIP Should Be Reauthorized for the Long-Term.**

  A 10-year reauthorization would avoid short-term extensions and program lapses that create uncertainty in both the insurance and the housing markets. Short-term reauthorizations do not provide the time to fully analyze the market and develop strategies to ensure a sustainable program.

- **NFIP Should be Transparent.**

  To ensure NFIP rates are not excessive, inadequate, or unfairly discriminatory, the rate making process needs to be overhauled and made more transparent to the public. This is a government-sponsored program and as such should be able to be understood by ratepayers and taxpayers.

- **NFIP Should Be Fair.**

  As a government program, NFIP should treat its customers equitably. NFIP should also adhere to insurance principles that rates must not be excessive, inadequate or unfairly discriminatory. This means that any necessary increases in premiums should be implemented with regard to customers' ability to absorb those increases. Further, properties should be rated based on their ability to withstand risk, not their use or ownership structure.

- **NFIP Reform Must Be Multi-Faceted and Comprehensive.**

  There is not one simple strategy to making NFIP sustainable and effective. It will take a combination of actions, addressed here, to ensure the protection of property in communities across the country that are so essential to our collective economic health.

KEY PROGRAM POLICY PRIORITIES

- **<u>Broaden the Base of Policy Holders – Spread the Risk</u>**

  According to FEMA, people located outside of mapped high-risk flood areas file more than 20 percent of all flood claims and receive one-third of Federal disaster assistance for flooding. Recognizing that nearly all properties have some risk of flooding, incentives should be created to encourage participation in the NFIP for property owners not located in high risk flood zones. Additionally, Congress should strengthen enforcement requirements for maintaining NFIP policies on all federally-backed mortgages. These actions will not only help protect those who are surprised by unpredicted flooding (which may be accelerating due to climate change), but also grow program revenue.

- **<u>Re-evaluate the Role of Write-Your-Own Companies</u>**

  The NFIP is largely implemented by private insurance companies that participate in FEMA's Write Your Own (WYO) program. Through the WYO program, private insurance companies enter into agreements with FEMA to sell and service flood insurance policies and adjust claims after flood losses. According to a 2007 GAO report, FEMA's payments to WYO insurance companies for operating costs ranged from more than a third to almost two-thirds of the total premiums paid by policyholders to the NFIP for fiscal years 2004 through 2006. From 2011 - 2014, WYO's earned $1.3B in profit from the program. There are several options to consider:

  - Reduce WYO commissions.
  - Require WYO companies to share some of the risk.
    - Remove the prohibition against WYO companies from offering their own stand-alone flood policies.
    - Require WYOs to cover a percentage of any loss. The WYO could purchase reinsurance with the rest of their book of business to cover that risk with little impact to their profitability.
    - Require WYOs to cover a percentage of legal costs related to litigation of claims, since WYOs do adjusting (as NFIP does not have its own adjusting staff).
  - Retire the WYOs and directly administer the program.

- **<u>Provide a More Reasonable Glide Path if rates must increase.</u>**

  Prior to 2012, FEMA had the authority to increase rates by no more than 10% per year. Under the 2014 Homeowners Flood Insurance Affordability Act (HFIAA), renewal premiums for certain properties (grandfathered and Pre-FIRM) will experience rate increases of between 18 percent and 25 percent until the full risk rate is reached. Meanwhile, the nation's CPI average has not exceeded 3.22% since 1990, and median incomes adjusted for inflation have remained stagnant.

Recognizing that 1) NFIP premiums often outpace property owners' ability to afford them, and 2) there are inherent flaws in determining the actual risk of individual properties, such increases appear arbitrary. A more reasonable glide path to higher rates provides greater economic stability and fairness. It would also allow time for property owners to evaluate alternatives to NFIP. For example, property owners may be unaware of the types of mitigation available to them. A more gradual increase in rates would allow them time to determine whether they can afford to mitigate; whether government financial assistance is available; or to consider other alternatives, including the feasibility of selling their property. Of equal importance, by authorizing more affordable rate increases, Congress will have sufficient time to review the affordability study and begin implementing any Federal assistance that may be needed to ensure premiums are affordable. Increases should be capped at 3% to 7%, which would still be more than twice the annual CPI.

Further, HFIAA restored grandfathering of rates for properties that were built to code but later re-mapped and covered by more stringent maps (for example, moving from an A-zone to a V-zone). This provision should remain unchanged in the reauthorization.

- **Ensure Rates are Consistent for *all* Properties.**

  HFIAA repealed the portions of the BW-12 that removed Pre-FIRM subsidies on properties purchased after July 6, 2012; however, the repeal only applies to primary residences. Non-primary residences (i.e., vacation rentals, investment properties, and businesses) will receive annual 25 percent premium increases until full-risk rates are achieved. Recognizing that most of these properties lend great support to the local and regional economies – and to ensure fairness – all properties should be treated the same and rated according to their ability to withstand risk, not their use or ownership status.

- **Increase Funding for Flood Mitigation.**

  In order to accelerate NFIP solvency, FEMA needs to aggressively buy down the risk associated with properties that have had the largest number of flood claims – namely, repetitive loss (RL) and Severe Repetitive Loss (SRL) properties. According to the GAO[1], about 1 percent of the 5.5 million properties currently insured by the program are considered repetitive loss properties – properties for which policyholders have made two or

[1] Government Accountability Office, National Flood Program: Actions to Address Repetitive Loss Properties; March 2004.

more $1,000 flood claims. However, about 38 percent of all program claim costs have been the result of repetitive loss properties, at a cost of about $4.6 billion since 1978. While Congress has created funding programs that provide mitigation grants for owners of both repetitive and non-repetitive loss properties, funding cannot keep pace with demand. For example, in Florida, there is a waiting list of property owners who want to mitigate their properties but do not have the resources to do so, and FEMA funding for the current fiscal year is no longer available. Accordingly, Congress should increase funding for FEMA's mitigation programs to help buy down the NFIP risk.

- **Encourage Growth in the Private Flood Insurance Market.**

  While it should be remembered that NFIP was established to fill a void created when the private market abandoned flood risk, the private market today could serve as a complement to NFIP and provide consumers with more choices. This could be facilitated by:

  - Requiring FEMA to share NFIP claims data with insurers and modelers so they can assess actual flood risks.
  - Eliminating the non-compete clause from the private WYO companies in NFIP. Reinstating prior FEMA rules that allowed policyholders to cancel an NFIP policy mid-term and receive a pro-rated refund if the NFIP policy is replaced with a private one.
  - Allowing state regulators the authority and discretion to regulate flood insurance policies as they do other insurance products.
  - Allowing policyholders to return to NFIP at their previous rate level should they choose to leave the private provider.
  - Applying Community Rating System discounts to private flood insurance policies.

  However, it should be understood that a significant move to privatize flood insurance could further damage the solvency of NFIP as private insurers choose to cover the safest risks, unless regulations require a full spectrum of risk to be taken up.

RELATED POLICY PRIORITIES

- **Improve and Accelerate the Mapping Process**

  Nationwide, NFIP flood maps are generally outdated and don't measure a community's flood risk accurately. Efforts should be made to (1) work directly with communities in the map revision process, ensuring locally-generated data and/or models are considered in map revisions, and (2) ensure individual property data (i.e., Finished Floor Elevations) are accounted for when maps are developed/revised. Generally, flood maps are developed on community-wide basis, incorporating site-specific data only when available. Unless efforts are made to include individual property data in the mapping process, both the risk and the premiums will be overstated.

- **Strengthen the Role of the Flood Insurance Consumer Advocate**

  Pursuant to HFIAA, FEMA has created a Flood Insurance Advocate to educate and assist property owners and policyholders on flood insurance issues, mapping issues including the map amendment process, and mitigation techniques. However, the authority and responsibilities of this position should be expanded. In Florida, insurance is a highly regulated industry that is overseen by the Florida Office of Insurance Regulation (OIR). The mission of the OIR is to ensure that insurance companies are financially viable and are offering insurance products at fair and adequate rates that do not discriminate against the buying public. To that end, insurance companies may only increase rates after they have been reviewed and approved by the OIR. This stands in stark contrast to the NFIP, where rate structures are neither scrutinized nor approved by an independent body.

  In addition to the inherent consumer protections of the OIR, Florida also has an Insurance Consumer Advocate to represent consumer interests in all insurance activities conducted under jurisdiction of the OIR. The Insurance Consumer Advocate also examines rate and form filings to assure rate changes are justified and that policies clearly and accurately reflect coverage provided.

  Recognizing that there is insufficient oversight of rate increases and virtually no consumer protections under the NFIP, Congress should seriously consider establishing an independent Flood Insurance Consumer Advocate and a policyholder appeal process for rate increases that reach a pre-established threshold. For example, Congress could determine that any policy holder whose annual premiums doubles or triples is entitled to have their policy reviewed by an independent entity to ensure the proposed increase is actuarially sound.

- **Streamline Grant Administration**

  Congress should also reexamine how FEMA's mitigation grants are managed so the process is streamlined and projects are accelerated. This can be done in a couple of ways. First, FEMA should work toward ensuring states can manage the grant programs with minimal Federal oversight. Currently, the grant approval process passes through three levels of government before it is approved. First, the local government applies on behalf of the property owner. Next, the application is reviewed for sufficiency, cost-effectiveness, and engineering by the state. Finally, the project is reviewed for sufficiency, cost-effectiveness, and engineering by FEMA. What appears to be a redundant review process is in fact a redundant and time-consuming process. Under certain conditions, FEMA has allowed states to manage grants directly – similar to HUD's Community Development Grant Program – and then conduct post grant audits to ensure the state complies with Federal laws and regulations. This approach saves significant time and greatly accelerates projects on the ground. Congress should direct FEMA to promote this tool and assist states in developing the capability to manage the programs.

Congress should also direct FEMA to examine how states can work directly with property owners to undertake mitigation. Under FEMA's mitigation programs, the state typically serves as the funding grantee, while the local government serves as the subgrantee, working on behalf of the property owner. However, in some instances, local governments are unwilling to participate in the program, which means property owners who may qualify for mitigation are unable to participate. While current law does not preclude states from working directly with the property owner, there are few incentives for them to take on this additional task.

- **Initiate Mitigation Voucher Pilot Program**

  Congress should consider developing a means-tested voucher program coupled with a low-interest loan program for investments in loss reduction measures, made affordable by reductions in risk-based premiums. An issue brief published by the Wharton Center for Risk Management and Decision Processes[2] proposes such a program that uses a combination voucher and loan program, where loans are provided to property owners for mitigation, while a government-sponsored voucher is used to help cover a portion of the premium and the loan. The need for such an alternative program is significant for two reasons. First, most property owners are unable to afford to elevate or flood proof their property without some form assistance. Second, the primary funding source at the state level is directed at properties that have one or more flood claims and, as such, Pre-FIRM homes that have not flooded have few opportunities to reduce their risk. FAC proposes that Congress authorize states like Florida to implement a mitigation voucher program using their existing Flood Mitigation Assistance (FMA) funds.

- **Establish Tax Credits to Provide Mitigation Incentives**

  Congress should evaluate the feasibility of a flood mitigation tax credit program. A tax credit to property owners who undertake flood mitigation would not only create an incentive to encourage loss reduction efforts, but it would: (1) reduce risk; (2) lower insurance rates; (3) help stabilize the NFIP; and, (4) decrease the need for other federal assistance associated flood disasters (i.e., temporary housing, debris removal). Such a credit program could be

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[2] Kousky, Carolyn and Kunreuther, Howard; Resources for the Future and the Wharton Rick Management and Decision Processes Center: *Addressing Affordability in the National Flood Insurance Program, Issue Brief 13-02*; August 2013

modeled after those used for energy efficiency initiatives, such as the Federal Residential Energy Efficiency Tax Credit Program.

- **Require a Long-Term Study on Alternative Approaches to NFIP Structure**

  There may be a more sustainable and efficient way to insure the nation's flood risk, particularly as it may increase given more extreme weather events. These could include transitioning NFIP to a residual market or a reinsurance backstop, or conversely emboldening NFIP to function more like a private market by investing surpluses and purchasing reinsurance. Any study should include implications for the housing market, affordability, exposure, the insurance market, the federal budget and long-term economic health.