

Summary

The National Flood Insurance Program (NFIP) is the main source of primary flood insurance coverage in the United States, collecting \$3.5 billion in premiums for over five million flood insurance policies. This is in contrast to the majority of other property and casualty risks, such as damage from fire or accidents, which are covered by a broad array of private insurance companies. One of the primary reasons behind the creation of the NFIP in 1968 was the withdrawal by private insurers from providing flood insurance coverage, leaving flood victims largely reliant on federal disaster assistance to recover after a flood. While private insurers have taken on relatively little flood risk, they have been involved in the administration of the NFIP through sales and servicing of policies and claims.

In recent years, private insurers have expressed increased interest in providing flood coverage. Advances in the analytics and data used to quantify flood risk along with increases in capital market capacities may allow private insurers to take on flood risks that they shunned in the past. Private flood insurance may offer some advantages over the NFIP, including more flexible flood policies, integrated coverage with homeowners insurance, or lower-cost coverage for some consumers. Private marketing might also increase the overall amount of flood coverage purchased, reducing the amount of extraordinary disaster assistance necessary to be provided by the federal government. Increased private coverage could reduce the overall financial risk to the NFIP, reducing the amount of NFIP borrowing necessary after major disasters.

Increasing private insurance, however, may have some downsides compared to the NFIP. Private coverage would not be guaranteed to be available to all floodplain residents, unlike the NFIP, and consumer protections could vary in different states. The role of the NFIP has historically been broader than just providing insurance. As currently authorized, the NFIP also encompasses social goals to provide flood insurance in flood-prone areas to property owners who otherwise would not be able to obtain it, and to reduce government's cost after floods. Through flood mapping and mitigation efforts, the NFIP has tried to reduce the future impact of floods, and it is unclear how effectively the NFIP could play this broader role if private insurance became a large part of the flood marketplace. Increased private insurance could also have an impact on the subsidies that are provided for some consumers through the NFIP.

The 2012 reauthorization of the NFIP (Title II of P.L. 112-141) included provisions encouraging private flood insurance; however, various barriers have remained. Legislation passed the House in the 114th Congress (H.R. 2901) which was intended to loosen requirements on private flood insurance, but it was not taken up by the Senate before the end of the 114th Congress.

The NFIP is currently operating under a short-term reauthorization until November 30, 2018. A bill for longer-term reauthorization (H.R. 2874) passed the House in November 2017. Three bills (S. 1313, S. 1368, and S. 1571) have been introduced in the Senate, but none have been acted on by the full Senate. H.R. 2874 includes several provisions intended to promote private flood insurance. S. 1313 mirrors some of these provisions, while the other Senate bills have fewer provisions promoting private flood insurance.

This report describes the current role of private insurers in U.S. flood insurance, and discusses barriers to expanding private sector involvement. The report considers potential effects of increased private sector involvement in the U.S. flood market, both for the NFIP and for consumers. Finally, the report outlines the provisions relevant to private flood insurance in the House and Senate NFIP reauthorization bills.

Contents

Introduction	1
Background	2
Objectives of the NFIP	2
Primary Flood Insurance Through the NFIP	3
The Mandatory Purchase Requirement	3
Premium Subsidies and Cross-Subsidies	4
NFIP Reauthorization and Legislation in the 115 th Congress	4
The Current Role of Private Insurers in the NFIP	5
Servicing of Policies and Claims Management	6
Reinsurance	6
Private Flood Insurance Outside the NFIP: Issues and Barriers	8
Flood Insurance Coverage “at Least as Broad as” the NFIP	9
Continuous Coverage	10
The “Non-Compete” Clause	10
NFIP Subsidized Rates	11
Regulatory Uncertainty	11
Ability to Assess Flood Risk Accurately	12
Adequate Consumer Participation	12
Potential Effects of Increased Private Sector Involvement in the Flood Market	13
Increased Consumer Choice	13
Cheaper Flood Insurance	14
Variable Consumer Protections	14
Adverse Selection	14
Issues for NFIP Flood Mapping and Floodplain Management	16
Concluding Comments	17

Tables

Table A-1. Provisions Related to Private Flood Insurance in Legislation in the 115 th Congress	25
---	----

Appendixes

Appendix. Provisions Related to Private Flood Insurance in Legislation in the 115 th Congress	20
--	----

Contacts

Author Contact Information	29
----------------------------------	----

Introduction

Congress is currently considering reauthorization of the National Flood Insurance Program (NFIP) during the 2018 hurricane season, while still dealing with the financial impact of the 2017 hurricane season. Total losses (insured and uninsured) for the 2017 hurricane season are estimated at a record \$270.3 billion, with losses for Hurricane Harvey estimated at \$127.5 billion, Hurricane Maria at \$91.8 billion, and Hurricane Irma at \$51.0 billion.¹ FEMA projects total NFIP claims for the three hurricanes at more than \$9.7 billion.² The NFIP is designed to borrow money from the Treasury to cover claims for extreme events;³ however, the 2017 losses would have pushed the program over its authorized borrowing limit. Rather than increase the borrowing limit, Congress canceled \$16 billion of NFIP debt to allow the program to pay claims.⁴

Expanding the availability of private flood insurance has been seen by many as an answer to the variability of the financial position of the NFIP.⁵ An increased role of private insurers could transfer more flood risk from policyholders to the private insurance sector, as opposed to transferring the risk to the federal government through the NFIP. In addition to the possible advantage to the NFIP, the increased availability of flood insurance as private companies enter the market may benefit households and businesses, as insured flood victims are likely to recover more quickly and more fully after a flood.

Private insurer interest in directly providing and underwriting flood risk has increased in recent years. Advances in the analytics and data used to quantify flood risk along with increases in capital market capacities may allow private insurers to take on flood risks that they shunned in the past. However, increasing the private sector role in providing flood insurance coverage directly to consumers may have implications for the operations and fiscal solvency of the NFIP as currently structured. Increased access to private flood insurance could provide individual policyholders with a wider choice of coverage and possibly cheaper premiums, but may also lead to variable consumer protections.

The extent to which private insurance companies participate in the U.S. flood insurance market represents an area of congressional concern. The NFIP is currently operating under a short-term reauthorization until November 30, 2018. A bill for longer-term reauthorization (H.R. 2874) passed the House in November 2017. Three bills (S. 1313, S. 1368, and S. 1571) have been introduced in the Senate, but none have been acted on by the full Senate. H.R. 2874 includes several provisions intended to promote private flood insurance. S. 1313 mirrors some of these provisions, while the other Senate bills have fewer provisions promoting private flood insurance. This report describes the current role of private insurers in U.S. flood insurance, and discusses barriers to private sector involvement. The report considers potential effects of increased private sector involvement in the U.S. flood market, both for the NFIP and for consumers. Finally, the

¹ Note that these figures include losses due to wind damage as well as flood damage.

² Email from FEMA Congressional Affairs staff, March 19, 2018. These are conservative numbers that do not include Loss Adjustment Expense (which would add approximately 5.3%), supplemental claims payments, or Increased Cost of Compliance expenditures.

³ The NFIP was not designed to retain funding to cover claims for truly extreme events; instead, the National Flood Insurance Act of 1968 allows the program to borrow money from the Treasury for such events (42 U.S.C. §4106(a)).

⁴ For more information on NFIP borrowing, see CRS Insight IN10784, *National Flood Insurance Program Borrowing Authority*, by Diane P. Horn.

⁵ FEMA, *National Flood Insurance Program Report to Congress on Reinsuring NFIP Insurance Risk and Options for Privatizing the NFIP*, August 13, 2015, p. 41, http://www.floods.org/ace-files/documentlibrary/2012_NFIP_Reform/Reinsuring_NFIP_Insurance_Risk_and_Options_for_Privatizing_the_NFIP_Report.pdf.

report outlines the provisions relevant to private flood insurance in the House and Senate NFIP reauthorization bills.

Background

The NFIP is the main provider of primary flood insurance coverage for residential properties in the United States, providing nearly \$1.28 trillion in coverage for over 5 million residential flood insurance policies. It also provides over \$66 billion in coverage for non-residential properties. The program collects about \$3.5 billion in annual premium revenue.⁶ Nationally, over 22,000 communities in 56 states and jurisdictions participate in the NFIP.⁷ The role of the federal government in flood insurance is in contrast to the majority of other property and casualty risks, such as damage from fire or accidents, which are covered by a broad array of private insurance companies. The premiums for this private insurance in 2017 totaled \$556 billion, with the policies backed by nearly \$2 trillion in assets held by private insurers.⁸

Objectives of the NFIP

The NFIP has two main policy goals: (1) to provide access to primary flood insurance, thereby allowing for the transfer of some of the financial risk of property owners to the federal government; and (2) to mitigate and reduce the nation's comprehensive flood risk⁹ through the development and implementation of floodplain management standards. A longer-term objective of the NFIP is to reduce federal expenditure on disaster assistance after floods.

As a public insurance program, the NFIP is designed differently from private-sector companies. As currently authorized, the NFIP also encompasses social goals to provide flood insurance in flood-prone areas to property owners who otherwise would not be able to obtain it, and to reduce government's cost after floods.¹⁰ The NFIP also engages in many "non-insurance" activities in the public interest: it disseminates flood risk information through flood maps, requires communities to adopt land use and building code standards in order to participate in the program, potentially reduces the need for other post-flood disaster aid, contributes to community resilience by providing a mechanism to fund rebuilding after a flood, and may protect lending institutions against mortgage defaults due to uninsured losses. The benefits of such tasks are not directly measured in the NFIP's financial results from selling flood insurance.¹¹

From the inception of the NFIP, the program has been expected to achieve multiple objectives, some of which may conflict with one another:

- To ensure reasonable insurance premiums for all;

⁶ Statistics on the National Flood Insurance Program (NFIP) policy and claims are available from the Federal Emergency Management Agency (FEMA) website at <https://www.fema.gov/policy-claim-statistics-flood-insurance>.

⁷ Detailed information about which communities participate and where is available from the Community Status Book, found on FEMA's website at <https://www.fema.gov/national-flood-insurance-program-community-status-book>.

⁸ Premium amounts used are net premiums written and asset amounts are admitted assets from A.M. Best, *Statistical Study: U.S. Property/Casualty - 2017 Financial Results*, March 26, 2018.

⁹ In the context of this report, *comprehensive* flood risk means that the risk includes both financial risk (i.e., physical damage to property), and also the risk to human life.

¹⁰ See 82 Stat. 573 for text in original statute (Section 1302(c) of P.L. 90-448). This language remains in statute (see 42 U.S.C. §4001(c)).

¹¹ American Academy of Actuaries Flood Insurance Work Group, *The National Flood Insurance Program: Challenges and Solutions*, April 2017, p. 79, <http://www.actuary.org/files/publications/FloodMonograph.04192017.pdf>.