

# NCOIL Summer Meeting

## Flood Insurance: What's Holding Back the Private Market?

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# About the American Academy of Actuaries

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# Overall Solvency of the NFIP

- The current debt is approximately \$24 billion
- After Katrina, the consensus was that paying off the debt would take decades, at the current rates and level of market penetration
  - Program takes in about \$3.5B in premiums
  - After paying for losses, expenses and interest on the debt, there is little left to pay down the debt
  - Any additional significant loss events would make it more difficult
  - Current interest rate is unusually low (borrowing cost of 50 basis points); any increase in interest rate would exacerbate the problem
- Climate change may increase the likelihood of high-intensity and costlier storms, thus making it more difficult for flood insurance premiums to sufficiently cover losses further increasing the NFIP debt
- Unlikely that program's financial viability will be secure before debt issue is resolved



# Potential Steps to Address the NFIP Debt

- Adjust insurance premiums
  - The Academy supports charging actuarial appropriate premiums that reflect the hazards of better-defined categories of insured risk
  - Enable financial stability for NFIP on long-term basis and fund future losses
- Change policies on properties that report multiple flood losses
  - About 1 percent of NFIP-insured properties have accounted for more than 33 percent of the claims paid, according to one estimate
- Expand insurance coverage
  - If a higher percentage of property owners in participating communities bought flood insurance, the added revenue would be available to help pay future claims
- Improve flood maps
  - The sooner FEMA can finalize updated flood maps, the more quickly insurance premiums can be adjusted to more accurately reflect underlying risk
- Shift private insurance companies into flood-insurance market
  - Have government act as a backstop



# GAO Recommendations to Increase Private Sector Involvement in Flood Insurance (Jan. 2014)

## ■ Eliminate Subsidized Rates

- Charge full risk rates to all policyholders that reflect full estimated risk of flooding
- Develop appropriate government funding for a direct, means-based subsidy to some policyholders
  - Subsidy should be explicit and provided directly to the policyholder instead of hidden in a discounted premium rate
    - Such hidden subsidies conceal a property's actual flood risk and encourage development in high-risk areas
  - Means-testing the subsidy would ensure that only those who could not afford the full-risk rates would receive premium assistance
  - More deliberate application of subsidy should increase the premium that the NFIP collects
  - Means-based subsidy may cause reduced home values due to the cost of flood insurance



# GAO Recommendations to Increase Private Sector Involvement in Flood Insurance (Jan. 2014) (cont'd)

- Establish government as insurer of last resort
- Involve the government as a reinsurer to private insurers
  - Create aggregate threshold dollar amount for claims payment by the government
  - Collect premiums from private insurers to fund government claims payment
- Enforce mandatory coverage
  - Homeowners' policies include flood peril as covered cause of loss, or all homeowners must purchase flood insurance
- Reinsure the NFIP in private market and/or utilize catastrophe bonds or other insurance-linked securities products
  - Purchase reinsurance from the private sector instead of borrowing from the Treasury
  - Adds uncertainty as private insurance market may withdraw from the market after an event



# Movement Toward Actuarial Soundness

- Biggert-Waters moved the NFIP towards more adequate rates
- But, even if all properties were given “actuarial” rates (rates that estimate the expected value of all future costs associated with an individual risk transfer), those rates have not historically had provisions for the cost of capital
  - However, assessment for reserve fund will be levied beginning later this year and may gradually begin to move the program closer to actuarially adequate rates
  - Accumulated goal of reserve fund will be one percent of total exposure (as measured by total in-force amount of insurance, currently \$1.2 trillion)
  - Reserve to be built up over years
- Many “actuarial” rates were intended to be implemented gradually, which made it possible for Congress to pass the Homeowner Flood Insurance Affordability Act of 2014, or Grimm-Waters. Grimm-Waters slowed the system of gradual increases created by Biggert-Waters.



# Changes to Rate Setting

- Subsidized rates phased out for:
  - Non-primary residences
  - Businesses
  - Severe repetitive loss properties
- Biggert-Waters prohibited offering of subsidized rates for:
  - Newly purchased properties
  - Lapsed policies
  - New policies issued after enactment of Biggert-Waters (July 6, 2012)
- BUT Grimm-Waters repealed prohibition against offering subsidies to prospective insureds for property not insured by July 6, 2012 or property purchased after that date.



# Other 2014 Grimm-Waters Rollback Provisions

- Restores “grandfathered rates” by removing catastrophic loss years from “average historical loss year” obligation for which chargeable premium rates must be adequate
- For policies purchased after enactment, some properties newly mapped into special flood hazard areas will receive “preferred risk premium” rates for first year, with gradual increases until rate reaches specified level
- Imposes on new or renewed policies a new annual premium surcharge; requires that such surcharge be deposited into Reserve Fund; and requires preparation of draft affordability framework
- Authorizes FEMA to obtain reinsurance of flood insurance coverage from private reinsurance and capital markets in an amount sufficient to maintain the claims paying ability of the flood insurance program



# Other 2014 Grimm-Waters Rollback Provisions (cont'd)

- Prohibits FEMA from estimating risk premium rates for flood insurance on property which, after July 6, 2012, experienced substantial improvement exceeding a certain percentage of its fair market value
- Directs FEMA to include in specified affordability study: options for maintaining affordability if annual premiums increase to amount greater than 2% of liability coverage amount under policy, including options for enhanced mitigation assistance and means-tested assistance and effects of establishment of catastrophe savings accounts on long-term affordability of coverage
- Repeals two-year delay in application of specified flood insurance premium and fee payment escrow requirements and exceptions to them
- Requires FEMA to update and maintain national flood rate maps with respect to areas protected by non-structural flood mitigation features



# Academy Recommendations to Current State of Flood Rates

- Establish a transition plan or a “glide-path” to financially sound rates instead of delaying the increases:
  - Enables transparency by allowing the NFIP to compute premiums based on capped and uncapped basis, thus explicitly computing the lost revenue;
  - Prepares policyholders for future increases as transition period phases out
- Removal of the grandfathering of subsidized rates on newly purchased properties
  - Subjects group to 25 percent increase limit already established for businesses and second homes;
  - Allows increase to be phased in over time while continuing a path toward financial stability
  - Allows for more time for completion of FEMA expense analysis and affordability study



# Additional Resources

- NFIP website: <http://www.floodsmart.gov/floodsmart>
- FEMA on Biggert-Waters: <http://www.fema.gov/flood-insurance-reform-act-2012>
- FEMA on the Severe Repetitive Loss Program: <http://www.fema.gov/severe-repetitive-loss-program>
- GAO Report on Flood Insurance: Strategies for Increasing Private Sector Involvement (Jan. 2014): <http://www.gao.gov/assets/670/660309.pdf>
- Academy letter on H.R. 3370 (Feb. 2014):  
[http://actuary.org/files/Nat\\_Cat\\_Subcommittee\\_comment\\_letter\\_on\\_amended\\_HR\\_3370\\_2.26.14.pdf](http://actuary.org/files/Nat_Cat_Subcommittee_comment_letter_on_amended_HR_3370_2.26.14.pdf)
- Academy Essential Elements on NFIP (March 2014):  
<http://www.actuary.org/files/Plugging%20Holes%20in%20U.S.%20Flood%20Insurance.pdf>
- Homeowner Flood Insurance Affordability Act of 2014 (March 2014):  
<https://beta.congress.gov/113/bills/hr3370/BILLS-113hr3370enr.pdf>





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