Plugging Holes in U.S. Flood Insurance

Flood insurance is vital to people and businesses that are located along the coastline or major rivers and waterways throughout the United States. But losses caused by flooding can also burden American taxpayers who live outside of the path of destruction because they are often obligated to pick up the tab for flood losses caused by major hurricanes and river flooding, which can destroy thousands of homes in a single disaster.

The National Flood Insurance Program (NFIP) was established in 1968 to provide flood insurance to homeowners, renters, and business owners in participating communities through collaboration between the federal government and private property insurance companies. The NFIP allows flood risks to be pooled on a nationwide basis so that the fund can theoretically absorb losses from periodic regional storms. The NFIP’s founding goals were to identify flood risks, set minimum national building standards in flood zones and encourage communities to exceed those standards, and provide flood insurance.

The NFIP had accumulated about $21 billion in debt to the U.S. Treasury by May 2017. (Official numbers for 2017 storms not available.) Those funds were used to pay off insurance claims from catastrophic storms and floods over the past decade. Insurance premiums paid by property owners in flood-prone areas are not expected to be enough to cover both future insurance claims and retire the NFIP’s debt. Additionally, with rising sea levels and the likelihood of costlier storms, insurance premiums will continue to be insufficient to cover losses, and the NFIP’s debt may rise further without reforms to the program.

However, raising flood insurance premiums too much too quickly could prompt homeowners and businesses to cancel their flood insurance policies or even relocate to other parts of the country. In an effort to make the NFIP more financially stable, Congress passed the Biggert-Waters Flood Insurance Reform Act in 2012, which substantially cut subsidies on flood insurance that had been provided to some property owners, and extended the program’s authorization for five years, through September 2017. Congress later delayed some premium increases after concerns were voiced by policyholders. Since September 2017, Congress has passed legislation authorizing several short-term extensions of the NFIP. The latest extension of the program is set to expire on Nov. 30, 2018, after which Congress must renew the program or risk flood insurance policy lapses.

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### Costliest U.S. Storms*

<table>
<thead>
<tr>
<th>Storm</th>
<th>Date</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>Hurricane Katrina</td>
<td>Aug. 2005</td>
<td>$16.3 billion</td>
</tr>
<tr>
<td>Hurricanes Harvey</td>
<td>Sept. 2017</td>
<td>$8.7 billion</td>
</tr>
<tr>
<td>SuperStorm Sandy</td>
<td>Oct. 2012</td>
<td>$8.25 billion</td>
</tr>
<tr>
<td>Hurricane Ike</td>
<td>Sept. 2008</td>
<td>$2.67 billion</td>
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<tr>
<td>Hurricane Ivan</td>
<td>Sept. 2004</td>
<td>$1.61 billion</td>
</tr>
<tr>
<td>Hurricane Irene</td>
<td>Aug. 2011</td>
<td>$1.34 billion</td>
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</tbody>
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*NFIP payouts Source: FEMA
Steps to Address the NFIP Debt

1. Revise financing of mega-storm losses
Most insurance systems have some plan for distributing losses from extreme events that include guaranty funds, catastrophe bonds, or government guarantees. Policymakers could rethink how the NFIP deals with losses from mega-storms like Hurricane Katrina, such as incorporating new private and public financing options.

2. Adjust insurance premiums
The Casualty Practice Council of the American Academy of Actuaries believes charging actuarially appropriate premiums that reflect the hazards of better-defined categories of insured risks is good public policy. This would make the NFIP more financially stable on a long-term basis and more likely to be able to fully fund future losses.

3. 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. Owners of properties that have incurred multiple claims for flood damage could be required to pay higher insurance premiums.

4. Expand insurance coverage
If a higher percentage of property owners in participating communities within flood-prone regions bought flood insurance, the added revenue would be available to help pay off debt and future claims.

5. Improve flood maps
Over the past few years, the Federal Emergency Management Agency (FEMA) has been updating flood maps to provide more accurate information about flood risks. The sooner FEMA can finalize updated flood maps, the more quickly insurance premiums can be adjusted to more accurately reflect the flood risk of a specific property.

6. Shift private insurance companies into flood-insurance market
Insurers have started offering commercial multi-peril policies that include flood coverage, and residential coverage above the limits available from the NFIP. However, private insurance still comprises a very small portion of the market. Legislation has been proposed in Congress that would help expand the private marketplace and make coverage more widely available.

Additional Resources from the American Academy of Actuaries

Flood Insurance Private Coverage: Questions for Regulators (July 2018)

The National Flood Insurance Program: Challenges and Solutions (April 2017)

Presentation on Role of Private Market in Flood Insurance (July 2014)