



Insight

The Dangers of All-peril Insurance

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Executive Summary

- The California wildfires have led to significant losses to human life and property, in part a consequence of a warming world that has made extreme weather events more common and more severe.
- In response, policymakers have proposed federal all-peril insurance or reinsurance programs, modeled on the National Flood Insurance Program (NFIP) but covering all weather-related events.
- The NFIP is a policy failure predicated on moral hazard, owes billions of dollars to the federal government, and should be an object lesson to policymakers in its failures; it is therefore a particularly poor model for any such all-peril insurance program.

Introduction

Beyond the human tragedy resulting from the California wildfires are the ever-expanding costs of rebuilding, which by some accounts now [exceed \\$250 billion](#), and of which as little as \$28 billion represent insured losses. Where historically many insurers had considered fire a “secondary peril,” the 2016 Fort McMurray wildfire in Alberta has driven an ongoing private-market reassessment of risk as revolutionary as the impact of Hurricane Andrew on hurricane insurance risk calculation.

But are private market solutions enough? The sheer scale of the likely losses due to the California wildfires – which may equal as much as 4 percent of California’s gross domestic product – has prompted some policymakers to consider the wrong lessons from the National Flood Insurance Program (NFIP), the principal provider of flood insurance in the United States as administered by the Federal Emergency Management Agency (FEMA). With the INSURE Act, these policymakers propose to extend the NFIP to cover “all perils,” taking an

expensive, cumbersome, and outdated federal program with a distorted view of risk and expanding it to cover all perils would simply be throwing bad money after worse.

The National Flood Insurance Program

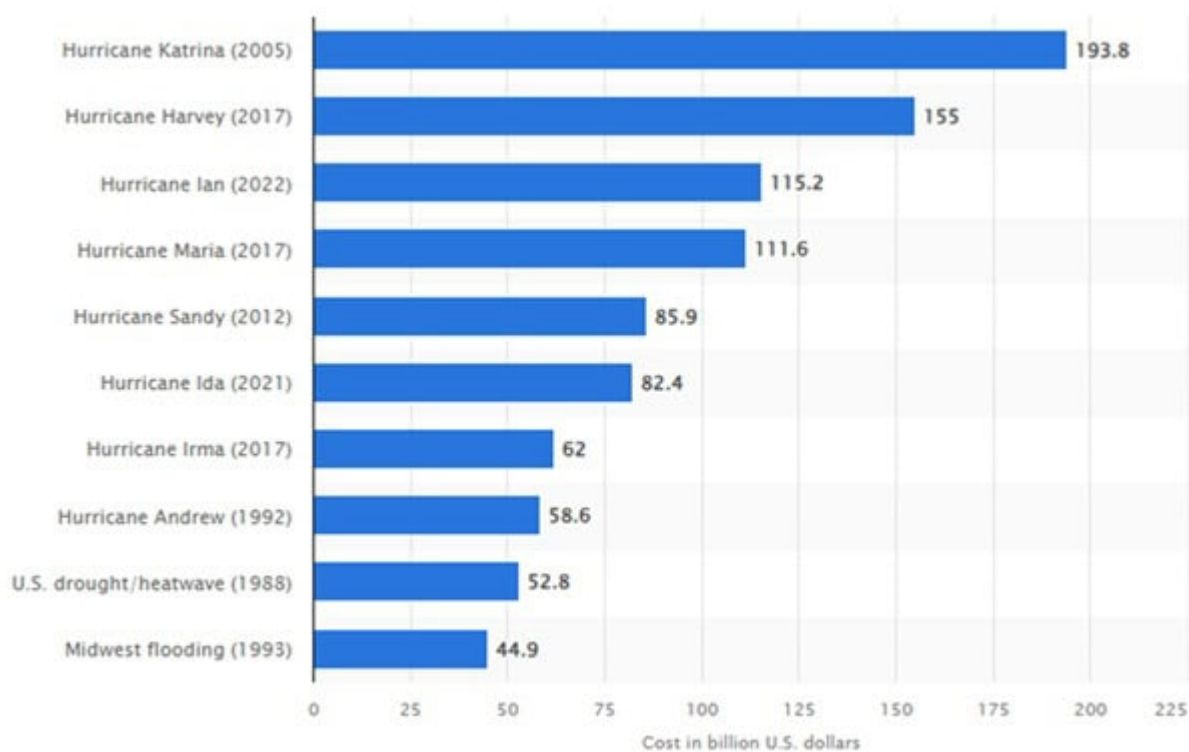
The NFIP is the principal provider of flood insurance in the United States and plays a crucial role in reducing the financial loss impacts of flooding for more than 5 million Americans. The NFIP was originally intended to be the facilitator of a private market of flood insurance and an insurer of last resort, but it has since morphed into the market itself via a burdensome federal program that has cost taxpayers at least \$40 billion, is losing \$600 million annually, and remains \$20.5 billion in debt to the Treasury.

While the program is inefficient and far more expensive than originally intended, structural reform has been difficult to accomplish. Since fiscal year 2017, for example, the program has undergone 32 short-term extensions and brief lapses. Instead of meaningfully reforming the NFIP's structure, Congress has preferred merely to reauthorize it – an approach it has taken for most of the program's 50-year history. Only two major reforms have been enacted across this period because legislators face an admittedly complicated problem: keeping flood insurance affordable while ensuring the program's fiscal solvency. Reform is made only more difficult politically as the issue is less one of partisan politics and more a feature of state geography, with coastal members of Congress pitted against those representing interior states.

As the frequency and severity of flooding and other extreme weather events increases, the United States must reconsider its relationship with the NFIP. Recent efforts to modernize pricing structures aside, the NFIP is a prime example of the moral hazard and dubious accountancy present when governments enter markets. That Congress has not managed to pass a clean authorization of the program, let alone embark on the wholesale reform it so badly needs, indicates that a government solution to this problem might not be possible or indeed desirable.

The INSURE Act

The frequency and intensity of severe weather events in the United States [is increasing](#), with the financial burden for these events falling on FEMA. Increasingly, however, the reserves at FEMA have proven insufficient and it has become necessary for state politicians to call on the administration and Congress for [additional disaster aid](#).



Source: [Statista](#)

Outside of federal disaster relief, however, private insurance has typically been the first line of defense for non-flood natural disasters, with reinsurance standing behind insurance to spread the burden. The INSURE Act, sponsored by Rep. Adam Schiff (D-CA) and first introduced in January 2024, would create a federal reinsurance entity covering all perils – at first flood, replacing and ending the NFIP, and later covering all natural disasters, from hurricanes to wildfires to earthquakes.

The INSURE Act would create a program that bears many of the fingerprints of the NFIP. It would include price controls (premium growth must not exceed 7 percent) that introduce moral hazard, encouraging developers to pursue growth in disaster-prone areas. Any requirements to pursue sensible risk management go out the window with an explicit federal backstop, incentivizing insurers to centralize their risk with the federal government. A federal program would devastate private reinsurance markets and would necessarily have adverse impacts on the insurance industry, leaving taxpayers accountable for spiraling costs. An astonishing 27 different voices across government, regulators, and industry would be involved in the creation of the new program, and make up the executive board, with only two of those consulted coming from backgrounds in reinsurance.

Perhaps the most vital concern, however, is how the federal government would pay for an

all-perils reinsurance backdrop. The INSURE Act proposes the infusion of start-up capital from Treasury to the tune of \$50 billion, but critics point to the enormous debts, even after forgiveness, of the NFIP. As of 2022, the NFIP continues to pay over [\\$280 million annually](#) in interest owed on that debt. The program paid out more than \$10 billion in claims in response to Hurricanes Harvey, Irma, and Maria, natural disasters that in total cost over \$300 billion in damages. Not only does this point to the relative scale of the federal and private insurance responses to these disasters, but these claims alone were enough to bring the NFIP to the limits of its borrowing authority, requiring the government to cancel billions of dollars of the NFIP's debt.

Alternative Methods

The federal government's response to the dangers posed by billion-dollar weather events must be proactive, not reactive, and there are three paths forward: implement a risk-based federal backstop that draws from the lessons of the NFIP; encourage private actors and address the causes of rising rates; or invest in disaster mitigation to lessen the need for disaster relief.

The federal government has a patchy record on the implementation of insurance and reinsurance programs. Policymakers looking to create an all-perils program would be wise to avoid the mistakes of the NFIP and consider the [successes](#) of the Terrorism Risk Insurance Program (TRIP). The Terrorism Risk Insurance Act, signed into law in 2002 following the September 11 attacks, created a federal backstop for insurance claims generated by acts of terror. While there is some concern that the ageing TRIP infrastructure is not equipped to deal with [cyber terrorism](#), the program has been hailed as an example of effective public-private partnership. Terrorism risk is extremely challenging to model, making it difficult to price risk and provide policies effectively – and a private market for terrorism risk insurance didn't exist. As a result of TRIP, terrorism risk insurance is both available and affordable; the market remains steady and insurers have not been discouraged from providing general property and casualty insurance. The success of any federal program relies on its ability to assess risk and apply rates as close to as effectively as the market can, without caps or subsidies. The federal government is at its most effective when it enables private actors to perform to the best of their abilities.

The INSURE Act received the endorsement of three consumer watchdogs that made [eyebrow-raising claims](#) that the reinsurance market is unregulated, suffers from market failures, and is unwilling to serve consumers. These spurious claims distract from the very real issues facing insurers and reinsurers, with reinsurance rates rising to [heights not seen in decades](#). Instead of blaming private markets, policymakers must consider the root causes of rate hikes: from global warming to coastal population shifts, as well as an ancient

regulatory and supervisory infrastructure.

Significant investment in resilience would help prevent and mitigate the impacts of severe weather events. In 2021 Congress created the Wildland Fire Mitigation and Management Commission to create policy solutions to the threat of wildfires. The [2023 report](#) extensively covers the options available to policymakers. It encourages better collaboration between federal agencies and non-federal entities and recommends expanding the size of federal disaster workforces and increasing the budget for pre-fire mitigation and post-fire restoration, and even examines the uses of beneficial fire.

Property developers must also be disincentivized from constructing new builds in areas prone to natural disaster and to ensure that new building codes are observed. Preparedness actions might include disaster warning systems and emergency response training.

Conclusions

The federal government must empower private actors to minimize both the likelihood and severity of extreme weather events, but purely private action may not be enough. A federal insurance program or reinsurance backstop may be both necessary and preferable to relying on FEMA and Congress. Any such program would do well to avoid the mistakes of the NFIP, beginning with sound actuarial and risk practices and ending with market-based pricing.