Insight

Proposed Reform to the National Flood Insurance Program

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Executive Summary

- In a bipartisan effort, the House Committee on Financial Services unanimously passed two bills on June 12 that would reform and reauthorize the National Flood Insurance Program (NFIP).
- Substantive reform of NFIP is needed: As per a March 2019 report, the NFIP remains $20.5 billion in debt to American taxpayers and is losing $600 million a year, and as a result any reform must be seen in light of the program's poor fiscal health.
- After nearly two years of short-term NFIP extensions and stagnating reform initiatives, the bills would fund the program for the next five years and make several other needed changes—yet the NFIP's debt from this 'affordability' raises concerns about the rising costs to taxpayers.

Context

The National Flood Insurance Program (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 over 5 million Americans. Administered by the Federal Emergency Management Agency (FEMA), the NFIP was originally intended to be a facilitator of privately underwritten flood insurance and an insurer of last resort, but it has since morphed into a large program that costs taxpayers $40 billion.

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 12 short-term extensions and brief lapses. Instead of meaningfully reforming the NFIP's structure, Congress has preferred merely to reauthorize it—an approach that Congress has taken for most of the program's 51-year history. Only two major reforms have been enacted in total 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 political parties and more a feature of state geography.

On June 12, however, the House Financial Services Committee unanimously passed two bills on the NFIP, indicating that Congress might be developing an appetite for substantial reform. The two bills—H.R. 3111 (The National Flood Insurance Program Administration Reform Act of 2019) and H.R. 3167 (The National Flood Insurance Program Reauthorization Act of 2019)—passed by bipartisan votes of 58 to 0 and 59 to 0, respectively. Narrower in scope, H.R. 3111 repositions the NFIP's relationship with private insurance providers. More broad, H.R. 3167 reauthorizes the NFIP for five years and provides substantial reforms to, as the bill notes, "increase affordability, improve mapping, enhance mitigation, and modernize the NFIP."

While these bills purport to make more than the obligatory changes, it is worth asking: Do the proposed reforms alleviate NFIP's problems, or make them worse?

Current Status of the NFIP

As the Congressional Research Service explains in its 2019 report, the NFIP currently owes roughly $20.5 billion to the U.S. Treasury. This debt "is conceptually owned by current and future participants in the NFIP," as policyholders' premium revenues in theory are set to pay off the debt. All told, the NFIP has borrowed a total of $40 billion, had $16 billion forgiven for claims brought on by Hurricanes Harvey, Irma, and Maria, and has returned only $2.82 billion of the original principal. Herein lies the instability of the program: government-subsidized monopolistic power has become the industry itself, leading to further debt that the current premiums or program structure cannot pay off.

How to Fix the NFIP

Before an analysis of the Financial Services Committee's current bills, we should first recall the reform proposals the American Action Forum (AAF) has suggested to the NFIP: 1) increase the size of the coverage pool, 2) charge premiums that accurately reflect the risk, 3) share risk with the private insurance market, and 4) update program technology.

Increase the size of the coverage pool

Of the 1.5 million Special Flood Hazard Areas (SFHA), risky areas in which flood insurance is mandated, only about 53 percent are insured. Uninsured properties will likely need more direct aid from FEMA in the wake of a disaster. Also, fewer properties having flood insurance means fewer premium payments to cover the costs of claims payouts. As a result, the number of NFIP policyholders should be increased, not only to raise the level of compliance among structures situated in SFHAs, but to raise the amount of premium revenue coming into the program so as to reduce NFIP's debt to taxpayers.

Charge premiums that accurately reflect the risk

Congress has attempted to keep premiums affordable by setting caps on premium increases, but the caps remain too low for the risk to be priced appropriately. In contrast to subsidized premiums are "full-risk" premiums, which are supposed to be high enough to cover the full risk of any given flood event for a particular property. Yet even these premiums do not account for rare, catastrophic flood losses such as those in 2005, 2012, and 2017.

NFIP policyholders should be charged premiums that reflect the actual amount of risk of loss to their properties. When buyers realize the higher flood insurance premiums, fewer potential buyers will bid on risky properties, which sends a signal to the market that decreased investment should be exposed to the most severe flood risk.

Share risk with the private insurance market

The NFIP should de-risk through the increased participation of private flood insurers. Not only would such a change reduce the NFIP's total exposure, but it would allow FEMA to focus on emergency relief work and flood-risk mitigation rather than underwriting flood insurance policies. To return to its original purpose, the NFIP should act as a reinsurer of last resort or provide primary insurance that is focused solely on residual market risks left over from what private flood insurers could not or would not underwrite.

Update program technology

Last, the NFIP should update its program technology. For example, homebuyers in SFHAs are required to purchase a new elevation certification that must be completed by a surveyor each time a property is bought and sold because there is no central database of the flood elevation data. By simply creating a central repository for flood zone data or allowing homebuyers to rely on GPS data instead of requiring the expense of a physical surveyor, the dissuasive costs of buying into the NFIP could be significantly reduced.

Comparing the Bills to the Recommended Reforms

Now, how do the latest proposed reforms match against these recommendations?

Implications of H.R. 3111

FEMA currently runs the Write Your Own (WYO) Program, an undertaking that allows private companies to write and service flood insurance in their own names, and H.R. 3111 provides further benefits to participants in this program. Enhancing this program is not to be confused with complete privatization of the industry, but rather it is a pseudo-privatization that, according to FEMA, allows companies to "receive an expense allowance for policies written and claims processed while the federal government retains responsibility for underwriting losses." This pseudo-privatization 1) allows private insurers to provide primary coverage to a majority of policyholders and 2) leaves NFIP as a reinsurer of last resort—two of the recommendations made above. This policy provides incentives to participate in WYO and lets the market underwrite flood insurance policies, giving FEMA liberty to pursue broader issues. The bill is necessarily a step in the right direction, as enhanced private participation in flood insurance can only reduce the NFIP's risk portfolio.

Implications of H.R. 3167

The weightier bill, H.R. 3167 reauthorizes the NFIP for five years. The reauthorization is important as it first prevents the program from lapsing, which has significant economic cost, and also would in theory give Congress more time to consider more comprehensive reform. Some reform is envisaged, however, including the appropriation of $500 million for improved mapping technology, a $100 million increase in the mapping budget. Although the cost to taxpayers does initially increase, this funding bump would follow the recommendation above to update program technology (particularly by creating a central depository for flood data). Additionally, this reform will provide prospective homeowners a couple of incentives: 1) By making it easier to opt into NFIP, this reform would boost NFIP enrollment, giving the program more policyholders and therefore more premiums (following suggestion above to increase the size of the coverage pool); and 2) by providing better information to potential buyers, better mapping could dissuade homeowners from moving to flood-prone areas, ultimately lessening NFIP claims as more people choose to live in safer places.

The bill's glaring omission is failing to reform the premiums the program charges homeowners. Neither the caps on premium increases nor full-risk premiums are increased, two key recommendations. Without premiums that accurately reflect the risk of property, the NFIP will see more of the same: As more claims are paid out than premiums received, we can reasonably expect that taxpayers will continue to incur an estimated per-year cost of $600 million. Premium-raising measures would indeed be politically challenging, but if NFIP's debt and its long-term sustainability are concerns, then these policies must be addressed, as the status quo leaves taxpayers on the hook for a continued $600 million per year.

A Path Forward

The unanimous passing of both H.R. 3111 and H.R. 3167 indicate that for the Financial Services Committee the reauthorization and reform of the flood insurance industry is a priority, especially considering that the bills include several substantive changes: Mapping is improved, beneficial programs are strengthened, and the NFIP is reauthorized for five years.

But the legislation takes insufficient action regarding premiums. While the proposed reform would likely decrease taxpayer liability while providing targeted and effective relief, without fundamentally restructuring the NFIP's approach to setting premiums the reforms proposed would likely not staunch the flow of taxpayer money out of the program. Factor in another environmental catastrophe, and the prospects of NFIP solvency become even more bleak.

That the NFIP finally faces a measure of substantive reform is to be welcomed. These bills cannot be the end of reform, however. Further action is needed to decrease the burden on American taxpayers and return the NFIP to its originally intended function.