Insight

The NFIP is Under Water

MEGHAN MILLOY | AUGUST 25, 2016

- The National Flood Insurance Program (NFIP) remains in over $23 billion of debt after the massive payouts from Hurricane Katrina and Superstorm Sandy. With a cash balance of only $1.2 billion, the National Flood Insurance Fund (NFIF) likely will be depleted after the payouts resulting from the recent Louisiana flooding, which have been estimated to be over $1.5 billion.
- Currently, the Program's premium prices are based solely on a property's position on a Flood Insurance Risk Map (FIRM), which is drawn by the Federal Emergency Management Agency (FEMA). Those maps are inaccurate, outdated, and do not accurately reflect the varying levels of risk associated with the properties and policies.
- Without any real reform, the payouts will continue to exceed the premiums collected, and the Program will be forced to rely on its borrowing authority from U.S. taxpayers.

Ever since the massive payouts following Superstorm Sandy, the NFIP has remained in a substantial amount of debt – approximately $23 billion. Now, with the recent flooding in Louisiana, which is being called the worst natural disaster since Superstorm Sandy, the NFIP will be forced to pay billions, in additional claims, for which it simply doesn't have the money.

As of September 2014, the NFIF which provides the financial resources for the NFIP, had a cash balance of $1.2 billion with a reserve fund of $157 million. One insurer already estimates that the Louisiana floods will result in insurance payouts of at least $1.5 billion, which would deplete both the NFIF's cash balance and reserve funds. Luckily for the NFIP policyholders, but not so lucky for the American taxpayers, the NFIF has another $6.4 billion in borrowing authority from the Treasury.

In fact, as the NFIP explained itself, "[u]nlike other public programs, the NFIP relies almost entirely on the ability to borrow from the U.S. Treasury when claims losses exhaust the National Flood Insurance Fund. U.S. Treasury borrowing has historically provided the NFIP with a retrospective source of risk funding. By comparison, transferring its insurance risk to the private sector through reinsurance would be a more expensive alternative for the NFIP."

That last sentence is not exactly accurate, however. As the American Action Forum proposed earlier this year, sharing flood insurance risk with the private insurance market is a step that the NFIP could take to return to self-sufficiency. There are several options for balancing the interests of low cost policies for homeowners and sustainable risk sharing. For example, some combination of scenarios in which private insurers either provide primary coverage to a majority of policyholders, or they acquire the transferred risk from the NFIF by way of reinsurance, or they jointly underwrite primary flood risk and pool any reinsurance would be highly effective. In any of those cases, the NFIP could act as a reinsurer of last resort or could provide primary insurance that is focused solely on residual market risks left over from what the private insurers could not underwrite.

Of course, no amount of public/private risk sharing will bring the NFIF back into the green if it continues to pay out more in claims than it takes in from premiums. Unfortunately for the NFIF, and the taxpayers that have to back its loans from Treasury, the NFIP continues to charge premiums that don’t accurately reflect the amount of risk of loss to the insurer properties. When the NFIP calculates premiums, it does so based on a FIRM that defines varying levels of flood risk based on variables like flood history, proximity to water, geographic features, infrastructure, etc., and assigns premium rates in broad segments depending on where a property lies on the map.

The most recent update to the FIRMs for the area affected by the Louisiana flooding was in 2013, with some as old as 2006. As a first step in setting more accurate premiums, the NFIP should update its FIRMS to better inform buyers and builders of the risk to their property and base its pricing decisions accordingly. Further, the NFIP should phase out the grandfathered premium rates that resulted solely from the previous, politically-motivated flood risk zone reclassifications. A GAO study on the issue found that NFIP’s own managerial malpractice has led to the use of inaccurate data when pricing payments and a lack of adequate procedures for managing insurance policy and claims date, despite a $40 million investment in a new IT management system. Risk of a catastrophic flood event is dependent on a number of impacts including weather patterns, infrastructure development, and erosion, and it is not the federal government’s (nor the taxpayers’) duty to assume the risk for every coastal property.

The massive devastation in Louisiana is as certain as the indebtedness of the NFIF. And until some major program changes occur, the program and its policyholders will stay at or below the status quo. When Congress renews the NFIP next year, it should look not only at affordability goals as the Homeowner Flood Insurance Affordability Act did in 2014 (even after a 2013 GAO study showed that only 8 percent of NFIP policyholders would see their premiums increase without legislative action), but it also should aim to reform the program to a point of efficient operation and self-sufficiency.