

Report on NFIP Reform

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*A Committee
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NFIP Reform: Where do things stand today?

NFIP: the National Flood Insurance program is a program administered through the Federal Emergency Management Agency (FEMA) that provides flood insurance to home and business owners.

Biggert-Waters: Federal legislation enacted in 2012 that aimed to remedy NFIP's perceived insolvency by phasing out subsidized insurance premium rates and shifting policies to current risk rates.

Homeowners Flood Insurance Affordability Act: (H.R. 3370) This act repealed certain portions of the Biggert-Waters Flood Insurance Reform Act of 2012 (BW12). From a residential homeowner's point of view, it repealed the most damaging parts of BW12.

LAMP: Levee Analysis Mapping Procedure initial implementation in 5 LA Parishes, 25 nationally.



NFIP Reform: What's Next?

The Entire National Flood Insurance Program is up for re-authorization in 2017:

BW12 extended the authorization of the NFIP for the 5 year period ending September 30th, 2017. Without a continuing resolution or re-authorization, the entire National Flood Insurance Program ends at that time.

- The program has been through well over 30 long and short term re-authorizations over the years.
- BW12 was supposed to be a permanent “FIX” to the solvency of the NFIP. BW12 was crafted without any input from us. HIFA was a Band-Aid to “FIX” parts of BW12.
- If we are not involved in this re-authorization process, someone else will “FIX” the NFIP for us again.

NFIP Reform: What's Needed?

First and Foremost, ALL changes to the NFIP should be made going forward. We can't punish people who played by FEMA's rules.

- This is an overarching principle that should be applied to all considered changes to the NFIP legislation.
- With the exception of Severe Repetitive Loss properties, all corrective legislation should be structured such that all existing policyholders (pre-firm or post-firm) of any property class (primary residence, non-primary residence, business or other) must be able to:
 - Be allowed to purchase Flood Insurance at approximately the same cost as before BW12 as long as there is no lapse in coverage or an accumulative claim equal to the FMV of the property.
 - Be allowed to sell or otherwise transfer title of the property to a new owner who will then be able to continue with insurance coverage as described above.

NFIP Reform: What's Needed?

The Solvency of the program must be addressed in a more equitable manner. We need to address program COST, not just REVENUE!

- From 1978 to 2013 the program collected over \$9.6B more in premiums than it paid in claims.
- And yet the program is \$25B in debt.
- This suggest severe issues with the cost of administrating and operating the program.
- The WYO insurance companies make a 30% margin on policy sales and they do not have to underwrite any of the risk.
- In all of the reform legislation to date, the only group asked to give more to correct this deficit in the NFIP is the policyholders through increased premiums.

NFIP Reform: What's Needed?

There is a huge lack of mandatory participation in the program:

It has been the law since 1973, that any a property mapped by FEMA in a Special Flood Hazard Area must purchase flood insurance if the property is mortgaged by a lending institution regulated by the Federal Government.

- In LA, we have better than 85% compliance with this requirement.
- But, nationally, a study done in 2006 showed that only 49% of those required to have flood insurance actually had it.
- Further, it is estimated that when “Super-storm Sandy” was heading up the eastern seaboard of the US, only 15-25% of the at risk population had flood insurance.
- BW12 increased the penalties to lending institutions for non-compliance. But, this law must be enforced.

NFIP Reform: What's Needed?

There is a big problem with the actuarial calculations used to determine the cost of insurance for the program:

BW12 required FEMA to include Catastrophic Loss years in the actuarial calculations which set the cost of Insurance. This greatly changes the method FEMA uses to determine the cost of Insurance.

- Standard Actuarial Practices for Insurance use Historic Loss years plus a reserve to calculate required premium rates.
- The American Academy of Actuaries reported to Congress that including Catastrophic loss years was not in line with Standard Actuarial Principles before BW12 was even passed.
- Also, we must consider how a program, designed to mitigate for 100 year flood loss through a quid pro relationship with local community's floodplain management be expected to absorb 400 year events?

NFIP Reform: What if we fail?

The potential impact is devastating:

- Astronomical flood insurance premium hikes escalating rapidly over time
- Home & Business values have already been lowered in some areas
- Drop in home and Business values impacts individual Homeowners and Business owners in what is likely their largest investment

Ripple Effects of flood insurance premium hikes:

- ↳ Drop in home and business value
 - ↳ Drop in home and business sales
 - ↳ Neighborhood-wide decrease in property values
 - ↳ Properties become unsalable
 - ↳ Banks lose mortgage portfolio
 - ↳ Real estate market freezes
 - ↳ Companies lose workers
 - ↳ Local governments lose tax base
 - ↳ Economies destroyed

THIS IS A FIGHT WE SIMPLY CAN'T AFFORD TO LOSE.

NFIP Reform: More details.

The following pages provide additional details, facts and required action for each of the pillars of this reform effort.

- I All Changes are Going Forward.
- II Enforce the Mandatory participation requirements in NFIP that already exist.
- III Address the Cost of Administration of the NFIP, not just the Revenue.
- IV Reverse the unreasonable change to FEMA's method of performing Actuary calculations brought on by BW12.
- V Pay for the CBO cost of these reforms.
- VI Re-Direct Funding to Identify and Mitigate existing risk in high potential loss areas.
- VII Reform the NFIP to Mitigate Residual Risk to new construction behind all flood control systems.

All Changes are Going Forward

Objective:

This is an overarching principle that applies to all proposed corrective action. With the exception of Severe Repetitive Loss (SRL) properties, any corrective Legislation proposed should be structured such that existing policyholders (pre-firm or post-firm) of any property class (primary residence, non-primary residence, business or other) must be able to continue to:

a.) Be allowed to purchase flood insurance at approximately the same cost as before BW12 (notwithstanding nominal fees proposed to pay for this legislation and build a reserve fund or typical limited FEMA discretionary yearly increases) up an until:

- 1) The property incurs flood related losses cumulatively equal to the Fair Market Value (FMV) of the property making it a SRL property.
- 2) There is a lapse in the policy.

b.) Be allowed to sell or otherwise transfer the title of the property to a new owner who shall be able to continue as described in a.) above.

Reasoning:

First and foremost, it is the fair and reasonable thing to do. These flood insurance policies were offered by FEMA, either pre-firm or post-firm as part of a quid pro quo arrangement to mitigate Flood Related cost to the Federal Government. They were offered by the Federal Government to the policyholders under the belief that doing so was equally beneficial to the Federal Government. Even pre-FIRM properties, the only policies considered as subsidized by FEMA, came with floodplain management restriction that FEMA required for the community to participate in the NFIP. The Federal Government not only implied that this affordable insurance would be available for the life of the property; it published and promoted the program accordingly. Citizens and businesses made huge financial decisions, in most cases the largest financial decision of their entire life, based on this promise of the Federal Government.

FEMA offers flood insurance in return for communities adopting floodplain management strategies that FEMA believes mitigates the risk of FEMA having to pay a claim for flooding in up to a 100 year flood event. FEMA estimates that this “unified floodplain management strategy” saves the nation an estimated \$1.6B annually in avoided flood losses. That is \$73.6B of mitigated flooding over the life of the program. The Map Modernization program that FEMA began in 2003 shows many areas previously mapped to be at a lower risk to currently be in a higher risk. But, the previous inaccuracy of the FEMA published prior map is not a reason to punish the policyholders.

Further, approximately 50% of the Nation’s Gross Domestic Product (GDP) is generated in Gulf and Atlantic Coastal Areas alone. The GDP percentage would be considerably larger if you include areas adjacent to our inland river systems. Contrary to popular belief in the restructuring of the NFIP, people live in these regions for a reason. That reason benefits the entire nation.

Legislation Requirements:

Consider every proposed legislative revision to the NFIP against this overarching principle. Reverse everything in BW12 that defeats this overarching principle. Prior to BW12, this was FEMA’s approach to the application of NFIP legislation.

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Enforce the Mandatory participation requirements in NFIP that already exist.

II

Objective:

The Flood Disaster Protection Act of 1973 established a mandatory flood insurance purchase requirement for structures located in an identified Special Flood Hazard Area (SFHA). With the passage of this act, federally regulated lenders were obligated to require flood insurance on any loan secured by improved real estate in a FEMA identified SFHA in NFIP participating communities. This requirement must be properly enforced.

Reasoning:

The forced placement of flood insurance for federally backed loans is a fundamental caveat in the quid pro quo relationship between the federal government and communities participating in the NFIP. The NFIP began in 1968 in response to hurricane Betsy in 1965. Hurricane Agnes in 1972 showed how limited the participation in NFIP was at that time. The Flood Disaster Protection Act of 1973 was supposed to force participation. But, some 20 years later, after the Midwest floods of 1993, Congress passed the 1994 National Flood Insurance Reform Act which provided impetus for strengthening lender compliance because participation in the NFIP was still very low. Even so, a 2006 study of the NFIP's mandatory purchase requirements by the Rand Corporation concluded that only 49% of the single family homes in SFHA carried flood insurance. Estimates are that only 15% to 25% of the properties in Northeast within SFHA were insured for flood loss as Super-storm Sandy approached. Nationally, recent reports indicate that as few as 18% of our citizens living in SFHA are protected by flood insurance.

Simply put, the Federal Government has performed very poorly at enforcing this cornerstone issue in the NFIP's ability to provide long term sustainable flood insurance where needed. The intent was to have all of these properties in the NFIP for two primary reasons. First, was to increase revenue to the NFIP and second, was to be able to use the insurance principle of the "Law of Large Numbers" to spread the risk to the program geographically.

BW12 section 100208 drastically increases the penalty to lending institutions for non-compliance with the forced placement requirement. The penalty is in place, up from \$350 to \$2000 per incidence; but, this incentive will do little good without enforcement. FEMA states that it is not responsible for oversight and regulation of the banking industry; which may be true. But, having such a gaping hole in a foundation of the NFIP should have been a grave concern for all involved.

Admittedly, the newly calculated flood insurance rates brought upon by the passage of BW12 would make enforcement highly unpopular with those who were not paying into the NFIP all of those years. As such, and due to the huge increase in revenue brought into the NFIP from such a change, the enforcement of this longstanding law should coincide with a revision to the actuary calculations on the cost of insurance.

Administrative Requirements:

There should be no need for further legislation on this issue as it is and has been a standing law for a long time now. However, Congress may have to force whatever Federal Agency that is responsible for enforcement to do so and to fund whatever enforcement action and authority that may be required. The actuarially based cost of insurance in the NFIP should be recalculated including the additional participants.

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Address the Cost of Administration of the NFIP, not just the Revenue.

III

Objective:

All of the reforms enacted by the passage of BW12 address a perceived revenue shortage in the solvency of the NFIP. No reforms to date seriously address the cost side of the equation. While it is true that appropriate mitigation strategies can reduce the cost of claims paid, the cost of administration of the NFIP by FEMA and its contractors as well as its Write Your Own (WYO) insurance agents is not addressed in any substantial way. FEMA, its contractors and the WYO agencies must be forced to find ways to reduce the administrative cost of the NFIP.

Reasoning:

A study of the value of premiums written by the policyholders as compared to the amount of claims paid by NFIP reveal some very telling statistics. The period from 1978 to 2013 is 36 years. The NFIP paid out more in claims than was paid in premiums by policyholders in only 9 of the 36 years. In every other one of the 27 years the NFIP collected more in premiums than it paid in claims. During that period, the NFIP collected just over \$9.67B more in premiums from the policyholders than it paid in claims to the policyholders.

Statistically, the largest outlier by a margin of approximately 5:1 over the closest other deviation (a gain of nearly \$3.2B in 2013) is the year 2005 which included hurricanes Katrina and Rita. If you take out 2005 the NFIP collected just over \$25.7B more in premiums than it paid in claims between 1978 and 2013. It can be argued that removing a single outlier is not a statistically sound evaluation method. As an alternative, we can use a truncated mean to isolate the central tendency by removing the top 7 revenue generating years and the top 7 revenue depleting years. In doing so, the NFIP still takes in nearly \$10.8B more in premiums than it paid in claims between 1978 and 2013.

There are 7 years during this period (1978 – 2013) that are called catastrophic loss years where the NFIP paid out more than \$1B in claims. These are 1995, 2001, 2004, 2005, 2008, 2011 & 2012. The fact that these years occur mostly late in the NFIP history are often used to indicate this is the shape of things to come. However, the 7 years where the NFIP collected the most over what it paid in premiums were in 2000, 2006, 2007, 2009, 2010, 2011, 2013. These are even later in the program history. If you take a look at 2011, FEMA statistics show that it is both a catastrophic loss year and a top revenue gaining year.

A program that consistently takes in more in premiums from the policyholders than it pays to the policyholders yet still finds itself in huge debt has an administrative cost / financial structure issue. It is unfair and unreasonable to think that the current deficit of this program could or should be correctly solely by increasing revenues from the policyholders. The program was never capitalized by Congress. Further, the current debt to the National Treasury owed by the NFIP, with a \$1B/year interest added on, is high, to say the least. However, when you consider that this debt was largely not the fault of the paying policyholders and that the US Government decided to take a loss of \$10.5B on General Motors alone, the beneficial national impacts of forgiving this current debt come into focus.

Legislative Requirements:

Force FEMA and the WYO agents to reduce the cost of administration of the NFIP. Consider forgiveness of the current debt (or at least interest charged) of the NFIP to the Nation's Treasury.

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Reverse the unreasonable change to FEMA's method of performing Actuary calculations brought on by BW12.

Objective:

The NFIP itself has a congressional mandate to be widely available and affordable. Until the passage of BW12, FEMA used generally accepted methods for actuarial calculations and setting the cost of insurance. The passage of BW12 (Section 100211) directs FEMA to include catastrophic loss years when assessing flood risk to set annual premium rates. Such a method is unsound given the parameters from which the program operates and must be reversed. This section of BW12 directly conflicts with itself.

Reasoning:

One cornerstone of the NFIP is that communities wanting to participate in the NFIP must adopt FEMA floodplain management regulations and enforce minimal building elevations in accordance with FEMA generated Flood Insurance Rate Maps (FIRMs). These FIRMs are produced via a Flood Insurance Study (FIS) conducted by FEMA to indicate the minimal elevation that a structure should be elevated to mitigate against the risk of FEMA having to pay a claim for a flood event having a 100 year return interval. Catastrophic loss years are almost always the results of a flood event having a much longer return interval. These are much larger events or storms such as Hurricane Katrina estimated to be a 400 year return event. A program that was intended to mitigate the risk of paying a flood claim for up to a 100 year flood event cannot be expected to be able to absorb these catastrophic loss years. Historically, the relief costs of such national catastrophes were funded through emergency supplemental appropriations or dedicated disaster funds under the Robert T. Stafford Act. The American Academy of Actuaries indicated that using catastrophic loss years was not appropriate prior to the passage of BW12. Generally accepted actuarial principles are designed to estimate the expected cost of future losses based on the average historical loss year. Including catastrophic loss years in the calculations is not in line with accepted actuarial principles and charging rates for insurance based on their inclusion will cause collection of premiums much higher than expected cost.

Others have advocated that the higher premiums caused by BW12 should be left in place and that an arbitrary premium cap be applied to policyholders based on means testing principles and the ability of the policyholder to pay. We do not support this approach as it leaves the perception of broadly subsidized policies within the program making it a target for future restructuring causing further prolonged instability in the markets served.

As currently structured, if the US is fortunate enough to go through a prolonged period of low impacts as it has before, the program policy revenues could go unchecked and the program could easily and quietly become a tax and spend program.

Legislative Requirements:

Pass legislation reversing section 100211 of BW12 or intervene in the administrative implementation of these calculations by FEMA. It is also important to consider the increase in the number of policies if we are successful in increasing participation as described in II above.

Pay for the Congressional Budget Office cost of these reforms.

Objective:

In order to make the revisions to this program revenue and cost neutral on the Nation's Budget, the impacts of proposed changes, as calculated by the Congressional Budget Office (CBO) should be paid for through an assessment fee widely distributed among all participating policyholders. This assessment fee should be phased out over time in favor of a reserve fund fee.

Reasoning:

The CBO has scored the recently passed Senate measure (S.1846) as having a cost of \$900M over the first 5 years and \$2.1B over 10 years. The Senate legislation effectively delays all of the major proposed revenue increasing schemes found in BW12. As such, it can be used as a basis for estimating the proposed changes discussed herein. Currently, there are 5.6 million NFIP policyholders. Whether charging an administrative fee of approximately \$40 dollars to generate \$220m/year or being more sophisticated by allowing a small percentage increase for all policy holders. The fee approach has a precedent, as FEMA has proposed a \$44/policy fee "to defray administrative expenses incurred in carrying out the NFIP." HIFA included \$25 and \$250 annual surcharges to make HR3370 score a Zero at the CBO.

Legislative Requirements:

The outline for the NFIP reform legislation proposed by the House addressed this concern adequately. This proves the ability to make significant impacts to the cost of the program with minimal surcharges widely distributed. Future legislation should incorporate similar techniques to keep cost of the program reasonable. Other alternatives affecting the entirety of the policyholders might also be considered.

Re-Direct Funding to Identify and Mitigate existing risk in high potential loss areas.

VI

Objective:

Currently, as a result of billions of dollars' worth of mapping efforts by FEMA over many years, there exist a wealth of information that can be used to identify the most at risk communities and the biggest threat of potential claims to be paid by the NFIP. A systematic program to identify and prioritizes the need to mitigate these potential risk to the NFIP should be implemented. Funds from within FEMA and other Federal sources should be directed to provide for the cost of infrastructure improvements or other mitigating actions to avoid catastrophic loss to both the residents and businesses in those areas and unsustainable losses to the NFIP itself.

Reasoning:

"An ounce of prevention is worth a pound of cure". Extrapolated for national flood disaster protection, I suppose that Benjamin Franklin would agree that one dollar spent today preventing a flood can save five dollars spent cleaning up the mess.

The historical benefits of the NFIP in providing mapping which has discouraged development in flood prone areas is often lost in the discussions about the NFIP. FEMA estimates savings from flood damage to be \$1.6B annually. Increased efforts in mapping and flood risk analysis will have a positive return on investment.

Legislative Requirements:

Have FEMA perform a study to identify the highest at risk communities with the highest overall risk to the NFIP considering the current level of protection in place at the time of the study. Identify funding sources available to provide services that mitigate the risk of flooding to large areas of the population at once in the communities identified as the most at risk to the NFIP.

Properly fund FEMA for this analysis and traditional mapping / mapping improvements.

Reform the NFIP to Mitigate Residual Risk to new construction behind all flood control systems.

VII

Objective:

Adopt new standards for future building in areas with existing 100-year protection to mitigate for the residual risk of living behind flood protection systems.

Reasoning:

A fundamental caveat of the NFIP is that if a community is protected by an accredited 100-year flood protection system, future construction can be developed at the existing grade of the land behind the flood protections system. No structural elevation is required. Critics of this process say that it encourages development in high risk areas and does not account for the residual risk and threat of flood events with a higher return interval than the 100-year event that the flood protection system was designed to protect against. It has also been suggested that these flood protection systems should be designed for 250 or 500 year return interval protection. While the higher level of protection would be desirable, the cost of just providing 100 year protection for riverine and coastal communities is daunting and a huge and often unachievable demand on Federal, State and Local Agencies.

Instead of attempting to raise the levees, we propose mitigating the residual risk by requiring a minimal elevation requirement tied to the height of the levee as determined by the FEMA Flood Insurance Study (FIS) for the community. When FEMA performs an FIS for a community it makes a determination as to the height that a flood protections system must be built to provide the intended 100-year flood protection. This height can be used as a reference for minimal base floor elevations for all future development within the polder created by the flood protection system. For example, any new development might be required to build at a minimal elevation of 1/3 of the required structural height of the flood protection system. Such a rule would minimize the residual risk of flooding by an amount equal to the figures determined from depth-damage curves assuming future development was unrestricted and built at grade. Further, the increased cost of development in the lowest lying areas within the flood protection polder would discourage poor development in these particular at risk areas. This section is intended to provide a basis for discussion of for improvements in mitigation strategies moving forward. Again, no retroactive consequence is suggested. Such a program might consider an opportunity to grandfather existing developmental plans and allow a community to make zoning type restrictions moving forward.

Legislative Requirements:

Consider adopting floodplain management strategies that use this or an equivalent method to compensate for the residual risk of building behind accredited flood protection systems.