National Flood Insurance Program
Key Questions of Financial Structure and Management

Background

Greater New Orleans, Inc. (GNO, Inc.) is the regional economic development organization for Southeast Louisiana. Since May 2013, GNO, Inc. has led a national group – the Coalition for Sustainable Flood Insurance (CSFI) – to address harmful changes to the National Flood Insurance Program: a confluence of the Biggert-Waters Act of 2012 (which was meant to stabilize NFIP), incomplete and inaccurate FEMA maps, and questionable actuarial calculations will lead to premium increases of up to 3,000% and more – for policyholders who have built to code and never flooded.

To be clear, GNO, Inc. is committed to a financially solvent NFIP and premiums that reflect true risk. We do not support policies that create moral hazard by incentivizing building in harm's way, nor do we support subsidization of severe repetitive loss properties. But there are hundreds of thousands of Americans who have done nothing wrong, have built exactly as the federal government has told them – and who now could have their lives destroyed.

If unchecked, the negative consequences are broad: owners will lose everything, values of unsellable properties will plummet, bank mortgages will go into default, local tax bases will erode, and economies will be eviscerated. We are already seeing this negative spiral in St. Charles parish, where values on some homes have been lowered 30% by the assessor – an unprecedented action. Ultimately, this "cascade effect" will undermine NFIP itself, as policyholders will leave an unaffordable program.

On August 8, 2013, GNO, Inc. hosted a roundtable with David Miller, FEMA Administrator for Flood Insurance and Mitigation, the Louisiana Congressional delegation and multiple Parish Presidents and officials. During the meeting, several questions were raised regarding the financial structure and management of NFIP that went unanswered. These issues, along with a lack of publicly available data, have raised serious questions about whether NFIP reforms were implemented based on complete information and analysis. With this in mind, GNO, Inc. was charged with producing a briefing to find answers to key questions of financial structure and management.

The following paper identifies the questions posed to FEMA, their responses, resulting analyses, and remaining issues.

These key questions about the financial structure and management of NFIP should be satisfactorily answered before the program is "fixed" at the expense of American home- and business-owners.

Questions

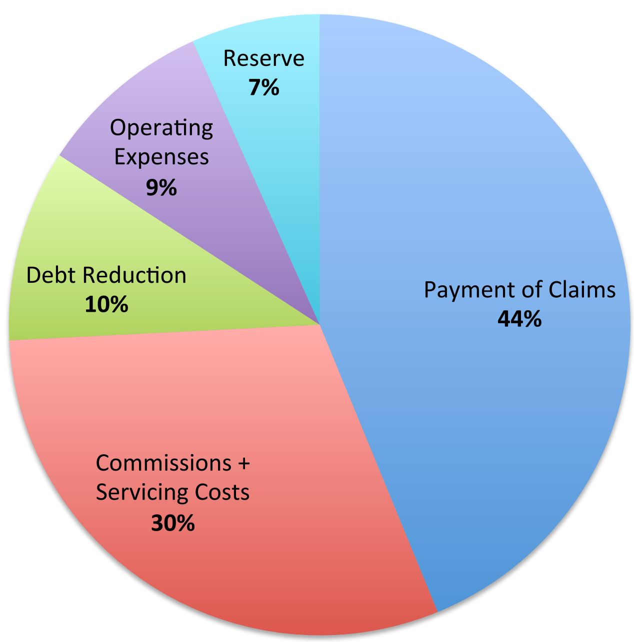
1. Over the past 30 years, NFIP has collected $6B more in premiums than have been paid out. Yet, FEMA asserts NFIP is $24B in deficit. How is this deficit calculated? What are premiums used for besides covering losses?

FEMA provided a document, "National Flood Insurance Fund Operating Results Summary FY 1969 through FY 2012," which is summarized below:

Income	1969 - 2012
Premiums	$ 44,842,821,000
Other Income	$ 1,641,307,000
Total Income	**$ 46,484,128,000**
Losses and Expenses	
Claims Paid	$ 44,710,350,000
Commissions	$ 11,435,473,000
Interest	$ 2,605,057,000
Other Expenses	$ 5,480,319,000
Total Expenses	**$ 64,231,199,000**
Net Surplus / Deficit	**$ (17,747,071,000)**

(The difference between the $18B deficit here and oft-cited $24B is projected Hurricane Sandy losses.)

Further, FEMA provided this breakdown of use of NFIP premiums for 2012[1]:



1 Commissions and Servicing Costs include Agents' Commissions (14%), Company Expenses (11%), Premium Tax (2%), and Loss Adjustment Expense (3%)

Notes

- FEMA explains that the fact that "Claims Paid" for 43 years almost exactly match (99.7%) "Premiums" is a coincidence
- As far as 30% of Premiums going towards "Commissions and Servicing Costs," FEMA writes that "12.5% to 13.4% of premium retained by insurance companies for their internal expenses is reasonable since it is based on comparisons to competitive industry lines of insurance.
- FEMA notes that, when needed, up to 63.5% of the premium can go towards payment of claims. This includes Payment of Claims, Operating Expenses, and Reserves.

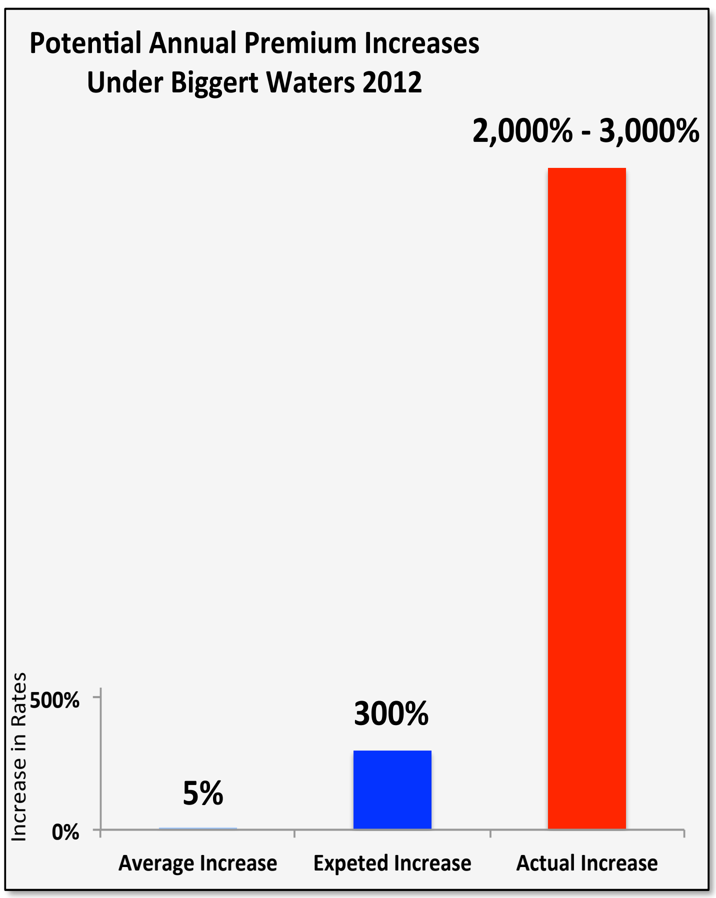
- **Considering that the insurance companies carry zero risk, should their payment be 30% of every premium, every year?**
- **Is it industry standard for of 44% an insurance premium to go towards payment of claims in a non-catastrophic year?**

2. Approximately how many policyholders will be affected by drastic premium increases?

Per FEMA, "only a subset of the Pre-FIRM will see substantial increases." This does not answer the question, however, as the vast majority of properties - 81% - are post-Firm (built after 1973).

FEMA also states, "we have only just begun the affordability study with the National Academy of Sciences and the study will help us quantify policy-holders who may see drastic increases. We expect that it will take more than a year to obtain this data." This affordability study was required to be completed 270 days after enactment of Biggert-Waters 2012. The affordability study should have been completed by April 2, 2013.

Clearly, premium increases should not be implemented until the affordability study is complete and the scope of impact is understood: 1,000,000 or more homes and businesses could be affected.



Sources: Insurance Information Institute; Estimate form CBO + GNO, Inc. interviews; GNO, Inc. research

3. Was any money swept from FEMA accounts by the federal government in years of surpluses, and if so, how much?

Per FEMA, no.

4. Approximately 40% of federally backed mortgages that are required to have flood insurance do not. Why is this not enforced? Would the program be solvent if everyone who is required to purchase flood insurance actually purchased it?

FEMA does not disagree with the assertion that nearly half of the individuals required to have flood insurance do not, and forgo paying into the system. According to FEMA:

- "FEMA is not responsible for regulating banks and mortgage holder participation in the program"
- "The program would not likely be solvent if all who are required to maintain flood insurance were in the program. There is very little economy of scale possible in insurance, as increased exposures would produce increased claims."
- "We are indifferent to growing the program." (i.e., enforcing full compliance)

These statements are problematic. Why does FEMA assume that the forty percent of mortgage holders not carrying mandatory flood insurance would produce proportionate increased claims?

- **It is more likely that the non-compliant 40% do not expect to flood. Therefore, their non-compliance:**
  - **Starves NFIP of nearly half its revenue**
  - **Concentrates the risk of those insured**
- **To state that "There is very little economy of scale possible in insurance," goes against a basic principle of insurance – diversifying risk over a large pool**

Conclusion

The National Flood Insurance Program requires reform to ensure its long-term financial stability. But in order to fix NFIP, we need to understand NFIP.

It is irresponsible to introduce drastic reforms that will potentially devastate hundreds of thousands of American home- and business-owners, before basic facts about NFIP are understood:

- Financial structure
- Number of homes and business affected
- Costs to policyholders
- Broad non-compliance

Answering these questions is basic to due process. To proceed otherwise, in what may amount to an illegal taking of property from law-abiding citizens, is both economically unwise and morally unjust.