Order Code RS22394
Updated June 6, 2006

CRS Report for Congress

Received through the CRS Web

National Flood Insurance Program: Treasury Borrowing in the Aftermath of Hurricane Katrina

Rawle O. King
Analyst in Industry Economics
Government and Finance Division

Summary

Claims and expenses related to the massive flooding caused by Hurricanes Katrina, Rita, and Wilma have financially overwhelmed the National Flood Insurance Program (NFIP). The program was self-supporting from 1986 until 2005, covering all expenses and claim payments out of cash flow of policy premiums and fees. The Federal Emergency Management Agency (FEMA), the agency that administers the NFIP, incurred liabilities estimated to total at least $23 billion as a result of the 2005 Gulf Coast hurricanes, exceeding the $2.2 billion in premiums earned annually and its $1.5 billion borrowing authority from the U.S. Treasury. As a result of the catastrophic property losses under the NFIP from Katrina, Rita, and Wilma, in September 2005, the Congress passed and the President signed into law legislation to increase NFIP borrowing authority first to $3.5 billion (P.L. 109-65) and then to $18.5 billion (P.L. 109-106) in November, 2005, and finally to $20.8 billion (P.L. 109-208) on March 23, 2006, to allow the agency to continue to pay claims.

FEMA estimates that the NFIP will need about $3 billion in additional borrowing authority to cover the claims currently outstanding. Under current law, funds borrowed from the Treasury must be repaid. However, most disaster experts would agree that FEMA will not be able to repay the current debt.

Members of the 109th Congress will likely be called upon to assess the NFIP's current operations and accomplishments. They might also consider various alternatives to reform the program while retaining its original intent to keep rates affordable for people to buy the insurance, thereby contributing towards pre-funding their recovery from a flood disaster.

This report will be updated as events warrant.

Introduction

The 2005 Atlantic hurricane season broke all records for hurricanes and tropical storms in a single year since modern storm recordkeeping began. There were 27 named storms in 2005, of which 14 were hurricanes, including Katrina, Rita, and Wilma. Additionally, 2005 saw three Category 5 hurricanes, which is the highest number in a season and equals half of the total number of Category 5 hurricanes on record.

Hurricane Katrina and the storm's aftermath will likely emerge as a pivotal event in the history of federal flood control policy.[1] The storm damage and subsequent massive flooding in the Gulf Coast and New Orleans from Hurricane Katrina, estimated to have caused over $200 billion in damages and over 1,700 deaths, was the most costly disaster in recent U.S. history. Hurricane Katrina exposed the fact that the cost of floods has continued to rise, as has the number of major flood disasters. Flood-related property losses have risen to $6 billion a year, from approximately $3.3 billion in the mid-1980s.[2] Katrina also demonstrated the effectiveness of the National Flood Insurance Program (NFIP) in managing the nation's flood risk as well as its limitations in handling a catastrophic flood event.

Congress created the NFIP with the passage of the National Flood Insurance Act of 1968[3] to provide insurance as an alternative to federal disaster assistance for individuals living in flood-prone areas. The NFIP has dual missions of promoting positive land use decision making and of reducing the overall cost to government of recovery costs due to flooding. The NFIP provides incentives for communities to establish flood plain management programs to control development in flood plain and promote flood-resistant construction.

Under the NFIP, the federal government is required to take certain actions:

- identify and map areas subject to flooding;
- indemnify property owners against flood losses by making flood insurance widely available at actuarially sound rates or with legally mandated subsidies; and
- reduce future flood-related losses through community floodplain management measures.

Since 1973, homeowners have had to buy flood insurance if they have federally backed mortgages in flood zones. Today, the NFIP provides flood insurance to about 4.8 million homeowners, renters, and business owners in over 20,118 participating communities, and generates $2.2 billion in premiums.

---

[1] For more information on the congressional interest in federal flood control policy see, CRS Report RL32972, *Federal Flood Insurance: The Repetitive Loss Problem*, by Rawle O. King.

[2] Alex Frangos, "U.S. Launching a Massive Effort to Redraw Nation's Flood Maps," *Wall Street Journal*, Sept. 19, 2003, p. A 1.

[3] P.L. 90-448; 82 Stat. 573.

The NFIP has undergone major changes in response to significant flood events. For example, the program was created after Hurricane Betsy devastated the Gulf Coast in 1965. Hurricane Agnes in 1972 led to the mandatory flood insurance requirements in 1973 that were designed to increase participation in the program. The Midwest flood of 1993 provided the impetus for strengthening lender compliance requirements in the context of the mandatory purchase provisions in the 1994 National Insurance Reform Act.[4] Recognition of the impact of properties prone to repetitive flooding on the financial condition of the program led to the passage of the Flood Insurance Reform Act of 2004.[5] In the wake of Hurricane Katrina, a question has been raised as to whether the current model for financing the NFIP — through premiums, fees, and treasury borrowing in high-claim years — remains the best alternative.

The devastation in the Gulf Coast caused by Hurricanes Katrina, Rita, and Wilma, and predictions for more intense storms in the future, have raised broad public policy concerns about the future viability of the NFIP, particularly in the event of another catastrophic flood episode. A key policy issue for the 109th Congress is finding a way to balance the financial and regulatory need to strengthen the program and ensure its future viability and commitment to reduce the nation's flood risks without undermining the original intent of the program to keep rates affordable. Members of the 109th Congress will likely be called upon to assess the NFIP's current operations and accomplishments and consider various alternatives to reform the program. The options for NFIP reforms include eliminating the program, broadening its coverage from the 100-year flood plain to the 500-year flood plain, and enhancing both the program's actuarial soundness and the accuracy of flood maps. Economists note that these flood insurance reforms could affect the U.S. economy and have unintended impacts on home ownership, including property values and the cost of mortgage credit.

Katrina's Impact on the National Flood Insurance Program

The massive flood losses from the 2005 hurricane season, especially Katrina and Rita, have financially overwhelmed the NFIP. The program had been self-supporting from 1986 until 2005, covering all expenses and claim payments out of income from premiums and fees. Operating losses occurred annually between 1972 and 1980 and in the years 1983, 1984, 1989, 1990, 1992, 1993, 1995, 1996, 2004, and 2005. The Federal Emergency Management Agency (FEMA), the agency that administers the program, expects to pay approximately $23 billion in claims from Hurricanes Katrina, Rita, and Wilma. This figure is almost double the total amount paid out over the NFIP's 37-year existence. According to FEMA, between 1978 — when the program was transferred from the Department of Housing and Urban Development to FEMA — and 2004, the NFIP earned $19.7 billion in premiums and paid out $14.2 billion. Some 257,549 NFIP claims have been filed in response to Katrina, Rita, and Wilma. To place this number in context, prior to Katrina, the largest numbers of flood-related claims from previous floods were

---

[4] P.L. 103-325; 108 Stat. 2255.

[5] P.L. 108-264; 118 Stat. 712.

from the Louisiana flood of May 1995 (31,264), Hurricane Allison in June 2001 (30,296), and Hurricane Ivan in 2004 (28,137).[6]

NFIP's Treasury Borrowing

One result of the catastrophic nature of flood losses from Hurricanes Katrina, Rita, and Wilma is that FEMA had to stop payments to NFIP policyholders for the first time since the flood insurance program began. Although the NFIP has been able to cover losses through the premiums charged to all policyholders, total income generated from insurance premiums and investments has at times been insufficient to pay claims in heavier loss years. In such cases, the program has borrowed from the U.S. Treasury to cover losses and other expenses in the short term.

Table 1 shows the history of Treasury borrowing and repayments under the NFIP from 1981 to 2005. When flood losses exceed the program's revenue, the NFIP is authorized to borrow up to $1.5 billion from the U.S. Treasury but must repay with interest what is borrowed.[7] In 2005, the program borrowed $300 million from the U.S. Treasury, due primarily to the 2004 hurricane season. Hurricanes Katrina, Rita, and Wilma struck in the fall of 2005, after the 2006 fiscal year began.

In 2005, the NFIP incurred a $1.04 billion net income loss. Total flood insurance losses from Katrina, Rita, and Wilma, estimated at $23 billion, significantly exceeded the program's $1.5 billion borrowing authority from the U.S. Treasury. Consequently, in September 2005, the Congress passed and the President signed into law legislation to increase NFIP borrowing authority to $3.5 billion[8]. Subsequent legislation that further raised borrowing authority to $18.5 billion was enacted in November, 2005.[9]

During congressional testimony before the Senate Banking Committee, FEMA indicated the NFIP would exceed the $18.5 billion borrowing limit by mid-February 2006, and would need an additional $5.6 billion to pay claims.[10] On March 23, 2006, the U.S. Congress approved S. 2275 to increase the borrowing authority to $20.8 billion.[11]

---

[6] See [http://www.fema.gov/nfip/sign1000.shtm], visited Jan. 30, 2006.

[7] P.L. 104-208; 110 Stat. 3009. The Omnibus Consolidated Appropriations Act of 1997 included a provision to increase the NFIP's borrowing authority for FY1997 to $1.5 billion from $1 billion.

[8] P.L. 109-65; 119 Stat. 1998.

[9] P.L. 109-106; 119 Stat. 2288.

[10] U.S. Congress, Senate Committee on Banking, Housing and Urban Affairs, Testimony of David I. Maurstad, Acting Director and Federal Insurance Administrator, Mitigation Division, Federal Emergency Management Agency, Department of Homeland Security, *Proposals to Reform the National Flood Insurance Program*, 109th Cong., 1st sess., (Washington: GPO, 2006), p. 1.

[11] P.L. 109-208.

Table 1. History of Treasury Borrowing and Repayments Under the National Flood Insurance Program
(as of August 31, 2005)

Fiscal Year	Amount Borrowed	Amount Repaid	Cumulative Debt
Prior to FY1981 *	$ 917,406,008	$ 0	$ 917,406,088
1981	164,614,526	624,970,099	457,050,435
1982	13,915,000	470,965,435	0
1983	50,000,000	0	50,000,000
1984	20,000,000	36,879,123	213,120,877
1985	0	213,120,877	0
1994 **	100,000,000	100,000,000	0
1995	265,000,000	0	265,000,000
1996	423,600,000	62,000,000	626,600,000
1997	530,000,000	239,600,000	917,000,000
1998	0	395,000,000	522,000,000
1999	400,000,000	381,000,000	541,000,000
2000	345,000,000	541,000,000	345,000,000
2001	600,000,000	345,000,000	600,000,000
2002	50,000,000	640,000,000	10,000,000
October 2002	0	10,000,000	0
2005	300,000,000	75,000,000	225,000,000
Total	**$4,359,535,534**	**$4,134,535,534**	**$225,000,000**

Source: Federal Emergency Management Agency's Office of Legislative Affairs.

Note: Borrowings through 1985 were repaid from congressional appropriations. Borrowings since 1994 have been repaid from premium and other income.
* Balance forward from U.S. Department of Housing and Urban Development.
** Of the $100 million borrowed, only $11 million was needed to cover obligations.

The NFIP is so deeply in debt from the 2004 and 2005 hurricane seasons that most insurance analysts would agree it will be challenging for FEMA to repay the money borrowed from the Treasury. The interest payments alone on NFIP's Treasury borrowing could reach $1 billion per year, which is half the program's annual premiums, suggesting the unlikelihood that FEMA will be able to repay the borrowed funds. During hearings on the NFIP before the Senate Banking Committee held on January 25 and February 2, 2006, most witnesses agreed the program needs to be reformed, and some went as far as to suggest the program should be restructured to operate more like a private insurer. Given the urgent need to avoid a lapse in paying claims, Congress is expected to act first to increase the borrowing authority by $3 billion to cover the remaining claims from the 2005 hurricanes, and then undertake a legislative review and possible overhaul of the program.

Federal Response to Uninsured Flood Losses

Katrina's devastation has required an unprecedented response from federal, state, and local governments, as well as the private sector. The federal government has committed more than $87 billion in spending and $8 billion in tax relief for the residents of the Gulf Coast and New Orleans. These funds, which were included in the Department of Defense Appropriations legislation, include $11.9 billion for Community Development Block

Grants to address the uninsured flood loss problem. The grants would be used to address the needs of homeowners. Funds will be allocated, in grants of up to $150,000, to certain eligible homeowners whose primary residences were destroyed or severely damaged following Hurricanes Katrina and Rita.

Other Legislative Action

Several bills are pending in Congress that would reform the NFIP. On March 16, 2006, the House Financial Services Committee approved H.R. 4973, the Flood Insurance Reform and Modernization Act, that would implement reforms designed to bring more consumers into the NFIP and gradually reduce premium subsidies for properties built before flood insurance rate maps (FIRMs) were developed. On May 25, 2006, the Senate Committee on Banking, Housing, and Urban Affairs approved in Executive Session the Flood Insurance Reform and Modernization Act of 2006. The Senate legislation, which does not yet have a number, would strengthen the NFIP by making the program more actuarially sound by phasing out premium subsidies on vacation homes, businesses, and severe repetitive loss properties built before the introduction of FIRMs on or before December 31, 1974, or before the effective date of an initial FIRM for the area.

S. 2005, introduced by Senator Jack Reed, would require FEMA to cooperate with state and community mapping efforts to establish, update, and monitor flood-risk zone data and estimate rates of loss caused by floods in flood-risk zones. The bill was referred on November 14, 2005, to the Senate Committee on Banking, Housing, and Urban Affairs, but no further action had been taken at the time of this writing.

In addition to stimulating calls to reform the NFIP, Hurricane Katrina has rekindled national debate as to whether the federal government should pay for catastrophe losses that are not covered by insurance either because the damage was caused by excluded perils, or because the insurance has become insolvent, or because the persons or entities suffering the losses were not insured. Because a future mega-catastrophic event could cripple the insurance industry's financial base and disrupt recovery after the next major disaster, there are renewed calls for federal disaster insurance. There is a lack of consensus, however, among state officials and insurance stakeholder groups about the viability of a federal catastrophe fund. Some segments of the insurance industry maintain a federal catastrophe fund is not needed because either the private sector remains capable of covering such risks or they are not willing to help with financial assistance to residents of coastal areas.[12] Supporters of this view argue that a government solution would amount to a coverage subsidy for coastal residents at the expense of those living further inland and increase the risk of taxpayers being forced to cover losses. On the other hand, other insurers and their trade groups say there is not enough capital in the catastrophe insurance market to handle a mega-catastrophe, and a federal-state catastrophe funding approach would be the most effective way to mobilize resources needed for disaster recovery and federal deficit reduction. Insurers and regulators are also exploring ways to allow for insurers to accumulate tax-deferred catastrophe reserves.

---

[12] Matt Brady, "War of Words Erupts Over Disaster Fund," *National Underwriter, Property & Casualty*, Jan. 23, 2006. p. 6.