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Private Flood Insurance in the National Flood Insurance Program (NFIP)

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The National Flood Insurance Program (NFIP)

The NFIP was first authorized by the National Flood Insurance Act of 1968 (42 U.S.C. §4001 *et seq*.), and was most recently reauthorized by the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12, Title II of P.L. 112-141). In statute, Congress has found that:

(1) many factors have made it uneconomic for the private insurance industry alone to make flood insurance available to those in need of such protection on reasonable terms and conditions; but

(2) a program of flood insurance with large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated. (42 U.S.C. §4001(b))

By law or regulation, federal agencies, federally regulated lending institutions, and government-sponsored enterprises must require certain property owners to purchase flood insurance as a condition of any mortgage that these entities make, guarantee, or purchase. Property owners are required to purchase flood insurance if their property is identified as being in a Special Flood Hazard Area (SFHA, which is equivalent to having a 1 in 100 or greater risk of annual flooding) and is in a community that participates in the NFIP. Historically, this has generally meant that such property owners were required to purchase a Standard Flood Insurance Policy (SFIP) from the NFIP. In BW-12, Congress explicitly allowed federal agencies to accept private flood insurance to fulfill this mortgage requirement instead of the SFIP, *if* the private flood insurance met the conditions defined further in statute at 42 U.S.C. 4012a(b)(7).

Rulemaking on Accepting Private Flood Insurance

In order to fulfill the mortgage requirement, a private insurance policy must provide, among other conditions, "flood insurance coverage which is at least as broad as the coverage provided under a [SFIP] … including when considering deductibles, exclusions, and conditions offered by the insurer." To implement this provision, the responsible federal agencies have issued a Notice of Proposed Rulemaking (NPRM) proposing

… a safe harbor to allow lenders to rely on the expertise of State insurance regulators. Under the proposed safe harbor, if a State insurance regulator makes a written determination that a flood insurance policy issued by a private insurer meets the definition of 'private flood insurance' set forth in the [National Flood Insurance Act], then the Agencies will deem such policy to meet the statutory definition of 'private flood insurance.'

Numerous public comments were received on the NPRM expressing concern with this approach. The federal agencies have not finalized the portion of the regulation dealing with the acceptance of private flood insurance, though they did finalize other components of the NPRM in a July 2015 final rule.

Legislation in the 114^{th} Congress

The Flood Insurance Market Parity and Modernization Act (H.R. 2901) was amended and ordered reported by the House Financial Services Committee. H.R. 2901 is scheduled for House floor consideration on April 26, 2016. The Senate version (S. 1679) has not been acted on in the Senate.

H.R. 2901 would revise the definition of *private flood insurance* previously defined in BW-12 at 42 U.S.C. 4012a(b)(7). The definition proposed would require federal agencies to accept private flood insurance from both admitted and non-admitted (i.e., surplus lines) insurers as long as the private insurance coverage "complies with the laws and regulations of that State." In revising the definition, H.R. 2901 as ordered reported would also strike existing statutory language describing how private flood insurance must provide coverage "as broad as the coverage" provided by the SFIP. In effect, this would allow individual states to determine most of the specifics of private flood insurance coverage accepted by federal agencies, federally regulated lending institutions, and government-sponsored enterprises (GSEs). The dollar amount of coverage would still have to meet federal statutory requirements and the GSEs may implement requirements relating to the financial strength of such companies offering flood insurance.

H.R. 2901 as ordered reported would also clarify that if a property owner purchases private flood insurance and decides then to return to a SFIP, they would be considered having maintained continuous coverage. This provision would allow such property owners to retain their right to any subsidy or cross-subsidy on their premium rate for insurance previously provided by the NFIP (namely, the pre-FIRM and grandfathering subsidies).

Supporters of the bill, including, for example, the National Association of Insurance Commissioners, have suggested that H.R. 2901/S. 1679 will increase the availability private flood insurance options for property owners. Some critics of the bill, including, for example, the Center for Economic Justice, have suggested that H.R. 2901/S. 1679 will allow the private market to "cherry-pick" (i.e., adversely select) the "profitable, lower-risk policies" of the NFIP policies of that are "overpriced" due to explicit cross-subsidization or imprecise flood insurance rate structures, while the government would retain those polices that benefit from those subsidies and imprecisions.

Options for Privatizing Flood Insurance

Section 100232(a) of BW-12 required both FEMA and the GAO to produce separate studies that "assess a broad range of options, methods, and strategies for privatizing the [NFIP]." In the GAO study on privatization, the GAO reviewed a wide range of alternative strategies to encourage private flood insurance. The strategies included eliminating subsidies of NFIP premium rates entirely, or providing the subsidies in an explicit form not hidden in the premium; shifting the federal role to reinsuring primary flood insurance instead of directly providing it; mandating flood coverage in homeowners insurance policies; and authorizing the NFIP to issue catastrophe bonds to transfer some of the insured risk.

The required FEMA study on privatization discussed several key challenges that may be presented by privatizing a larger segment of NFIP policy base, including how to:

- Maintain the funding of federal flood mapping and flood mitigation programs largely paid for through SFIP premiums;

- Reduce and pay off the $23 billion in debt owed to the U.S. Treasury by the NFIP, which is currently only paid for through premiums on SFIPs; and
- Ensure the affordability and continued availability of flood insurance to property owners in flood zones.