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INSIGHT

Selected Issues for National Flood Insurance Program (NFIP) Reauthorization and Reform: Homeland Security Issues in the 116th Congress

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Homeland Security Issues in the 116th Congress

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NFIP Reauthorization

The National Flood Insurance Program (NFIP) is the primary source of flood insurance for residential properties in the United States. The NFIP has more than 5 million flood insurance policies providing over $1.3 trillion in coverage, with 22,493 communities in 56 states and jurisdictions participating. Since the end of FY2017, 16 short-term NFIP reauthorizations have been enacted, and the NFIP is currently authorized until September 30, 2021. Unless reauthorized or amended by Congress, on September 31, 2021, (1) the authority to provide *new* flood insurance contracts will expire and (2) the authority for the NFIP to borrow funds from the Treasury will be reduced from $30.425 billion to $1 billion.

A number of bills were introduced in the 116th Congress to provide longer-term reauthorization of the NFIP and other changes to the program. The National Flood Insurance Program Reauthorization Act of 2019 (H.R. 3167) was reported (H.Rept. 116-262) by the House Financial Services Committee. The National Flood Insurance Program Reauthorization and Reform Act of 2019 (S. 2187), with a companion bill, H.R. 3872, introduced on July 22, 2019.

Historically, Congress has asked the Federal Emergency Management Agency (FEMA) to set NFIP premiums that are simultaneously "risk-based" and "reasonable." Except for certain subsidies, statute directs that NFIP flood insurance rates should reflect the true flood risk to the property. Properties paying less than the full risk-based rate are determined by the date when the structure was built relative to the date of the community's Flood Insurance Rate Map (FIRM), rather than the flood risk or the policyholder's ability to pay. Congress has directed FEMA to subsidize flood insurance for properties built before the community's first FIRM (the *pre-FIRM subsidy*). When FIRMs are updated, FEMA also "grandfathers" properties at their rate from past FIRMs through a cross-subsidy. Under existing law, pre-FIRM subsidies are being phased out, whereas grandfathering is retained indefinitely.

Reforming the premium structure to reflect full risk-based rates could place the NFIP on a more financially sustainable path, risk-based price signals could give policyholders a clearer understanding of their true flood risk, and a reformed rate structure could encourage more private insurers to enter the market. However, charging risk-based premiums may mean that insurance for some properties becomes unaffordable. FEMA currently does not have the authority or funding to implement an affordability program. An NFIP-funded affordability program would require either raising flood insurance rates for NFIP policyholders or diverting resources from another existing use.

Properties with Multiple Losses

An area of controversy involves NFIP coverage of properties that have suffered multiple flood losses. One concern is the cost to the program; another is whether the NFIP should continue to insure properties that are likely to have further losses. According to FEMA, claims on repetitive loss (RL) and severe repetitive loss (SRL) properties since 1968 amount to approximately $17 billion, or approximately 30% of claims paid. Reducing the number of RL and SRL properties, through mitigation or relocation, could reduce claims and improve the NFIP's financial position. Under current statute, the NFIP cannot refuse to insure any property; however, from April 1, 2019, FEMA introduced an SRL premium equal to 5% of the annual premium.

Private Flood Insurance

Private insurers play a major role in administering the NFIP through the Write-Your-Own (WYO) program, where private insurance companies are paid to issue and service NFIP policies. WYO companies take on little flood risk themselves; instead, the NFIP retains the financial risk of paying claims for these policies. Few private insurers compete with the NFIP in the primary residential flood insurance market. However, private insurer interest in providing flood coverage has increased recently, and many see private insurance as a way of transferring flood risk from the federal government to the private sector. For example, FEMA has transferred flood risk to the capital markets through reinsurance in 2017, 2018, 2019, and 2020.

Private flood insurance may offer some potential advantages over the NFIP, including more flexible policies, broader coverage, integrated coverage with homeowners' insurance, business interruption insurance, or lower-cost coverage for some consumers. Private marketing also might increase the overall amount of flood coverage purchased. More people purchasing flood insurance, either NFIP or private, could help to reduce the amount of disaster assistance provided by the federal government. Increasing private insurance, however, may have some disadvantages compared to the NFIP. Unlike the NFIP, private coverage availability would not be guaranteed to all floodplain residents, and consumer protections could vary in different states. In addition, private sector competition might increase the financial exposure and volatility of the NFIP, as private markets likely will seek out policies that offer the greatest likelihood of profit. In the most extreme case, the private market might "cherry-pick" (i.e., adversely select) the profitable, lower-risk NFIP policies that are "overpriced" either due to cross-subsidization or imprecise rate structures. This could leave the NFIP with a higher density of actuarially unsound policies that are directly subsidized or benefit from cross-subsidization. An increase in private flood insurance policies that "depopulates" the NFIP also may undermine the NFIP's ability to generate revenue, reducing the ability or extending the time required to repay previously incurred debt.

The NFIP's role has historically been broader than just providing insurance. As currently authorized, the NFIP also encompasses social goals to provide flood insurance in flood-prone areas to those who otherwise would not be able to obtain it and to reduce the government's cost after floods. The NFIP has tried to reduce the impact of floods through flood-mapping and mitigation efforts. It is unclear how effectively the NFIP could play this broader role if private insurance became a large part of the flood marketplace. The majority of funding for flood mapping and floodplain management comes from the Federal Policy Fee (FPF), paid by all NFIP policyholders. To the extent that the private flood insurance market grows and policies move from the NFIP to private insurers, FEMA would no longer collect the FPF on those policies and less money would be available for floodplain mapping and management.

Author Information

Diane P. Horn
Analyst in Flood Insurance and Emergency Management

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