CRS INSIGHT

What Happens If the National Flood Insurance Program (NFIP) Lapses?

April 16, 2018 (IN10835)

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This Insight provides a short overview of what would happen if the NFIP were not to be reauthorized by July 31, 2018, and allowed to lapse. See CRS Report R45099, *National Flood Insurance Program: Selected Issues and Legislation in the 115th Congress* for the current status of NFIP reauthorization legislation.

Expiration of Certain NFIP Authorities

The National Flood Insurance Program (NFIP) is authorized by the National Flood Insurance Act of 1968 (Title XIII of P.L. 90-448, as amended, 42 U.S.C. §4001 et seq.). The NFIP does not contain a single comprehensive expiration, termination, or sunset provision for the whole of the program. Rather, the NFIP has multiple different legal provisions that tie to the expiration of key components of the program.

Authorization of the NFIP was extended from September 30 until December 8, 2017 (Section 130 of P.L. 115-56), extended until December 22, 2017 (P.L. 115-90), and again until January 19, 2018 (P.L. 115-96). The NFIP lapsed between January 20 and January 22, 2018, and received a fourth short-term reauthorization until February 8, 2018 (P.L. 115-120). This legislation also authorized FEMA to honor all policy-related transactions accepted during the NFIP lapse. The NFIP lapsed again for approximately eight hours during a brief government shut-down in the early morning of February 9, 2018, and was then reauthorized until March 23, 2018 (P.L. 115-123). The NFIP received a sixth reauthorization until July 31, 2018

(P.L.115-141).

The cancellation of $16 billion of NFIP debt (P.L. 115-72) has no effect on the impact of a lapse of NFIP authorization. The 21st Century Flood Reform Act (H.R. 2874), passed by the House in November 2017, would reauthorize the NFIP until September 30, 2022. Three bills have been introduced in the Senate to extend the NFIP authorization (S. 1313, S. 1368, and S. 1571), but the Senate Banking Committee has yet to take any formal action.

Unless reauthorized or amended by Congress, the following will occur on July 31, 2018:

- The authority to provide *new* flood insurance contracts will expire. Flood insurance contracts entered into before the expiration would continue until the end of their policy term of one year.
- The authority for NFIP to borrow funds from the Treasury will be reduced from $30.425 billion to $1 billion.

Other activities of the program would technically remain authorized, such as the issuance of Flood Mitigation Assistance Grants. However, the expiration of the key authorities listed above would have potentially significant impacts on the remaining NFIP activities.

The NFIP is the primary source of flood insurance coverage for residential properties in the United States. As of January 2018, the NFIP had over 5 million flood insurance policies providing nearly $1.28 trillion in coverage, with approximately 23,000 communities in 56 states and jurisdictions participating. The program collects about $3.6 billion in annual premium revenue.

If there were to be a lapse in authorization on or after July 31, 2018, and the borrowing authority is reduced to $1 billion, FEMA would continue to adjust and pay claims as premium dollars come into the National Flood Insurance Fund (NFIF) and reserve fund. If the funds available to pay claims were to be depleted, claims would have to wait until sufficient premiums were received to pay them unless Congress were to appropriate supplemental funds to the NFIP to pay claims or increase the borrowing limit.

The Mandatory Purchase Requirement

The expiration of the NFIP's authority to provide new flood insurance contracts has potentially significant implications due to the mandatory purchase requirement. 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, both residential and commercial, 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 an estimated 1% or greater risk of flooding every year) and is in a community that participates in the NFIP. Without available flood insurance, real estate transactions in an SFHA would be potentially significantly hampered.

In the Biggert-Waters Flood Insurance Reform Act of 2012 (Title II of P.L. 112-141), Congress explicitly allowed federal agencies to accept private flood insurance to fulfill this mortgage requirement if the private flood insurance met the conditions defined in statute. The private flood insurance market, however, has been slow to develop and the mandatory purchase requirement is still generally met through NFIP coverage.

Past Lapses of the NFIP

The NFIP was extended 17 times between 2008 and 2012, and lapsed four times: March 1 to March 2, 2010; March 29 to April 15, 2010; June 1 to July 2, 2010; and October 1 to October 5, 2011. In most cases when the NFIP lapsed, Congress reauthorized the NFIP retroactively. During these NFIP lapses, the FDIC issued guidance to lending institutions, and the Federal Reserve also issued informal guidance to lenders. FEMA provided guidance for the Write-Your-Own (WYO) Program, where private insurance companies are paid to write and service NFIP policies.

In past NFIP lapses, borrowers were not able to obtain flood insurance to close, renew, or increase loans secured by property in a SFHA until the NFIP was reauthorized. During the lapse in June 2010, estimates suggest that over 1,400 home sale closings were cancelled or delayed each day, representing over 40,000 sales per month. These figures applied to residential properties, but commercial properties were also affected by the NFIP lapse. In addition, the largest WYO insurer left the NFIP in 2011 reportedly because of the administrative burden associated with very short-term reauthorizations and lapses in authorization. Although no detailed analysis of the NFIP lapses in 2010 and 2011 has been undertaken, the economic impact could potentially have been broader than the reported effects on the domestic real estate market.

CRS INSIGHT

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

April 16, 2018 (IN10450)

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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 reauthorized until the end of FY2017 by the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12, Title II of P.L. 112-141). After a series of short-term reauthorizations, P.L. 115-141 reauthorized the NFIP until July 31, 2018. 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 (GSEs) 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% or greater* risk of flooding every year) 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

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." The implementation of this requirement has proved challenging, with the responsible federal agencies issuing two separate Notices of Proposed Rulemaking (NPRM) addressing the issue in October 2013 and November 2016. The crux of the implementation issue can be seen as answering the question of who would judge whether specific policies met the "at least as broad as" standard and what criteria would be used in making this judgment? The uncertainty as to whether particular private policies would meet the standard has been cited as "at odds with" greater private participation in the flood insurance marketplace.

Legislation in the 115th Congress

H.R. 2874, the 21st Century Flood Reform Act, passed the House on a vote of 237 to 189 on November 14, 2017. H.R. 2874 would revise the definition of *private flood insurance* previously defined in BW-12. 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. 2874 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 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. 2874 would clarify that if a property owner purchases private flood insurance and decides then to return to the NFIP, they would be considered having maintained *continuous coverage*. Continuous coverage is required for property owners to retain any subsidies or cross-subsidies in their NFIP premium rates. A borrower may be reluctant to purchase private insurance if doing so means they would lose their subsidy should they later decide to return to NFIP coverage. The bill attempts to address that concern.

Supporters of the legislation including, for example, the National Association of Insurance Commissioners, have suggested that it will increase the availability of 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. 2874 will allow the private market to "cherry-pick" (i.e., adversely select) the "profitable, lower-risk policies" of the NFIP policies 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 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 billions of dollars of debt NFIP owes to the U.S. Treasury; and
- ensure the affordability and continued availability of flood insurance to property owners in flood zones.
- For further discussion of the possible role of private insurance in the NFIP, see CRS Report R45099, *National Flood Insurance Program: Selected Issues and Legislation in the 115th Congress*.

CRS INSIGHT

The National Flood Insurance Program (NFIP), Reinsurance, and Catastrophe Bonds

April 17, 2018 (IN10887)

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Insurance generally serves to transfer risk from one entity who does not want to bear that risk to another entity that does. An initial insurance purchase, such as homeowners buying a policy to cover damage to their home, however, is often only the first transfer of that risk. The initial (or *primary*) insurer may then transfer (or *cede*) some or all of this risk to another company or investor, such as a *reinsurer*. Such risk transfers are, on the whole, a net cost for primary insurers, just as purchasing insurance is a net cost for homeowners.

The Homeowner Flood Insurance Affordability Act of 2014 (P.L. 113-89) revised the authority of the National Flood Insurance Program (NFIP) to secure reinsurance from "private reinsurance and capital markets." Risk transfer from the private market could reduce the likelihood of the Federal Emergency Management Agency (FEMA) needing to borrow from the Treasury to pay claims. In addition, this could allow the NFIP to recognize some of its flood risk up front through the premiums it pays for risk transfers rather than after the fact borrowing from Treasury. Using reinsurance to cover losses that occur in the more extreme years could help the NFIP to reduce the volatility of its losses over time. However, because reinsurers understandably charge the NFIP premiums to compensate for the assumed risk as well as the reinsurers' costs and profit margins, the primary benefit of reinsurance is to manage risk, not to reduce the NFIP's long-term fiscal exposure.

Reinsurance

The most common form of risk transfer is for a primary insurer to purchase a policy covering its risks from another (re)insurer. The primary insurer would typically continue to service the policy, while the reinsurer operates in the background. Reinsurance is particularly important to smaller insurers, who may not be large enough to spread local risks that are geographically correlated, such as a storm hitting a particular area. Reinsurers, however, often have the scope to diversify their risks on a global scale. It is also not uncommon for reinsurers to transfer (or *retrocede*) risks to other reinsurers.

National Flood Insurance Program (NFIP) Purchase of Reinsurance

Begun in September 2016 with a small amount to test the market, larger reinsurance purchases began in January 2017, as FEMA purchased $1.042 billion of reinsurance for an annual premium of $150 million. The reinsurance covered 26% of losses between $4 billion and $8 billion arising from a single flooding event. FEMA has so far paid over $8.6 billion in claims for Hurricane Harvey, triggering a full claim on the 2017 reinsurance.

FEMA purchased $1.46 billion of reinsurance in January 2018, for a premium of $235 million. The agreement is structured to cover losses in 2018 above $4 billion for a single flooding event, covering 18.6% of losses between $4 billion and $6 billion, and 54.3% of losses between $6 billion and $8 billion.

Catastrophe Bonds

In addition to reinsurance, new forms of "alternative" risk transfer have also been developed. One category of alternative risk transfer instruments are known as insurance linked securities (ILS)—financial instruments whose values are driven by insurance loss events. The most common form of ILS are catastrophe bonds (or cat bonds), which are structured somewhat like other bonds, but whose payout is dependent on the occurrence of a particular catastrophe, like a hurricane or earthquake of a particular strength.

Catastrophe bonds were first used in the private sector in the mid-1990s following Hurricane Andrew and the Northridge earthquake. Catastrophe bonds transfer major natural disaster risks to capital market investors. Such bonds are tradable and access global capital markets more directly than reinsurance, where a reinsurer acts as an intermediary. Catastrophe bonds are structured so that payment depends on the occurrence of an event of a defined magnitude or that causes an aggregate insurance loss in excess of a stipulated amount. Only when these specific triggering conditions are met do investors begin to lose their investment. There are three main types of triggers:

- *Indemnity*—bonds triggered by the actual losses experienced by the sponsoring insurer following the occurrence of a specified event; e.g., a bond triggered if an insurer's residential property losses from a hurricane in Florida exceeded $25 million in 2018;
- *Industry Loss*—bonds triggered by a predetermined threshold of industry-wide losses following the occurrence of a specified event; e.g., a bond triggered if a total of all

insurers' residential property losses from floods in 2018 exceeded $20 billion; or

- *Parametric*—bonds triggered by the actual physical conditions occurring during a disaster such as wind speed or earthquake size; e.g., a bond triggered by an eight-meter storm surge hitting New Orleans in 2018.

The public sector has become increasingly interested in the use of bonds. In 2009, Mexico became the first sovereign to issue cat bonds and the World Bank is now one of the largest participants in the catastrophe bond market. The New York City Metropolitan Transit Authority issued catastrophe bonds to protect against storm surge. According to the insurer Swiss Re, more than $10.5 billion in catastrophe bonds were issued in 2017, with the overall amount outstanding at $278.0 billion.

NFIP and Catastrophe Bonds

In April 2018, FEMA announced that it would seek to transfer NFIP risk to private markets through an ILS transaction. According to the notice of procurement, this would happen through a reinsurance procurement in which the reinsurer acts as a transformer to transfer NFIP-insured flood risk through the issuance of a catastrophe bond, to be effective for a term of "likely" three years. The notice also indicates that proceeds from the issuance of the catastrophe bond would be transferred into a reinsurance trust account, with FEMA as the sole beneficiary, for satisfying claims under the reinsurance agreement between FEMA and the transforming reinsurer. Thus, apparently, the catastrophe bonds would not be issued by the United States as a sovereign entity, but instead would be issued by the private reinsurer. The amount of the cat bond and the precise design are not yet known.

CRS INSIGHT

National Flood Insurance Program Borrowing Authority

April 16, 2018 (IN10784)

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This Insight evaluates the National Flood Insurance Program (NFIP) borrowing authority to receive loans from the U.S. Department of the Treasury, particularly in the context of major floods, and discusses the current financial situation of the NFIP.

NFIP Funding

Funding for the NFIP is primarily maintained in an authorized account called the National Flood Insurance Fund (NFIF). Generally, the NFIP has been funded from receipts from the premiums of flood insurance policies, including fees and surcharges; direct annual appropriations for specific costs of the NFIP (currently only flood mapping); and borrowing from the Treasury when the balance of the NFIF has been insufficient to pay the NFIP's obligations (e.g., insurance claims). Key provisions of the NFIP were extended from September 30 until December 8, 2017 (Section 130 of P.L. 115-56), extended again until December 22, 2017 (P.L. 115-90), and again until January 19, 2018 (P.L. 115-96). The NFIP lapsed between January 20 and January 22, 2018, and received a fourth short-term reauthorization until February 8, 2018 (P.L. 115-120). The NFIP lapsed again for approximately eight hours during a brief government shut-down in the early morning of February 9 and was then reauthorized until March 23, 2018 (P.L. 115-123). The NFIP received a sixth reauthorization until July 31, 2018 (P.L.115-141). However, these extensions did not increase the NFIP's borrowing limit or provide additional funds to the NFIP.

NFIP Borrowing Authority

The NFIP was not designed to retain funding to cover claims for truly extreme events; instead, the National Flood Insurance Act of 1968 allows the program to borrow money from the Treasury for such events. For most of the NFIP's history, the program has generally been able to cover its costs, borrowing relatively small amounts from the Treasury to pay claims, and then repaying the loans with interest. **Table 1** and **Table 2** show NFIP borrowing, repayments, and debt from 1981 to 2017. Comparable figures are not available before 1980. When the NFIP was first established, the borrowing limit was $250 million. In 1973, the borrowing limit was increased to $500 million, or $1 billion with the approval of the President. The borrowing limit was increased to $1.5 billion in 1996; however, borrowing at that level was not required prior to 2005. The largest debt was $917 million in 1997, which was steadily reduced to zero by the end of FY2003. However, Congress increased the level of borrowing to pay claims in the aftermath of the 2005 hurricane season (particularly Hurricanes Katrina, Rita, and Wilma). Congress increased the borrowing limit to $18.5 billion in November 2005, and further increased the borrowing limit to $20.775 billion in March 2006. In July 2010, the borrowing limit was decreased to $20.725 billion. In 2013, following Hurricane Sandy, Congress increased the borrowing limit to the current $30.425 billion. The Biggert-Waters Flood Insurance Reform Act of 2012 established a reserve fund to cover future expenses, especially those from catastrophic disasters. Since the 2005 hurricane season, the NFIP has made six principal repayments totaling $2.82 billion and has paid $3.83 billion in interest. The program is currently paying nearly $400 million annually in interest. In January 2017, the NFIP borrowed $1.6 billion due to losses in 2016 (the Louisiana floods and Hurricane Matthew) and debt repayments.

Table 1. NFIP Borrowing FY1980 to FY1998

(Nominal dollars)

Fiscal Year	Amount Borrowed	Amount Repaid	Cumulative Debt
1980	917,406,008	0	917,406,008
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	200,000,000	36,879,123	213,120,877
1985	0	213,120,877	0
1986	0	0	0

1987	0	0	0
1988	0	0	0
1989	0	0	0
1990	0	0	0
1991	0	0	0
1992	0	0	0
1993	0	0	0
1994	100,000,000	100,000,000	0
1995	265,000,000	265,000,000	0
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

Source: CRS analysis of data provided by FEMA Congressional Affairs, November 20, 2017.

Table 2. NFIP Borrowing FY1999 to FY2018

(Nominal dollars)

Fiscal Year	Amount Borrowed	Amount Repaid	Cumulative Debt
1999	400,000,000	381,000,000	541,000,000

2000	345,000,000	541,000,000	600,000,000
2001	600,000,000	345,000,000	600,000,000
2002	50,000,000	640,000,000	10,000,000
2003	0	10,000,000	0
2004	0	0	0
2005	300,000,000	75,000,000	225,000,000
2006	16,600,000,000	0	16,885,000,000
2007	650,000,000	0	17,735,000,000
2008	50,000,000	225,000,000	17,360,000,000
2009	1,987,988,421	347,988,421	19,000,000,000
2010	0	500,000,000	18,500,000,000
2011	0	750,000,000	17,750,000,000
2012	0	0	17,750,000,000
2013	6,250,000,000	0	24,000,000,000
2014	0	1,000,000,000	23,000,000,000
2015	0	0	23,000,000,000
2016	0	0	23,000,000,000

2017	13,525,000,000	16,000,000,000[a]	20,525,000,000
2018	0	0	20,525,000,000

Source: CRS analysis of data provided by FEMA Congressional Affairs, November 20, 2017.

a. The $16 billion of debt was cancelled rather than repaid (P.L. 115-72, Title III, §308).

Hurricanes Harvey, Irma, and Maria

On September 22, 2017, FEMA borrowed the remaining $5.825 billion from the Treasury, reaching the NFIP's authorized borrowing limit of $30.425 billion. On October 26, 2017, $16 billion of NFIP debt was cancelled to make it possible for the program to pay claims for Hurricanes Harvey, Irma, and Maria. This represents the first time that NFIP debt has been cancelled, although Congress appropriated funds between 1980 and 1985 to repay NFIP debt. FEMA borrowed another $6.1 billion on November 9, 2017, to fund estimated 2017 losses, including those incurred by Hurricanes Harvey, Irma, and Maria, bringing the debt up to $20.525 billion. The NFIP currently has $9.9 billion of remaining borrowing authority.

In January 2017, FEMA paid a $150 million premium to purchase $1.042 billion of reinsurance. The contract was structured to pay 26% of the losses between $4 billion and $8 billion arising from a single flooding event. FEMA has already paid over $8.6 billion in claims for Hurricane Harvey, triggering a full claim on the 2017 reinsurance. FEMA projects total NFIP claims for Hurricane Harvey of $8.7 to $8.84 billion, for Hurricane Irma of $1.003 to $1.04 billion, and for Hurricane Maria of $25 to $34 million.