Rethinking the NFIP: Straw Man Policy Options

Community-Based Insurance Policy Options

Description of Policy Theme:

Who pays the cost for development at the beach?

Establishing a direct link between the land use and construction decisions of a community and the full cost of flood would require communities to balance development decisions with the potential for increased risk, and the cost of that risk.

This policy option seeks to broaden the participation of various entities in weighing the economic benefits and costs of floodplain development. The current National Flood Insurance Program (NFIP) structure disperses roles and responsibilities among a variety of actors, and municipal land-use decisions do not account for the full cost of flood. Coupling of private construction decisions and the cost of insurance exists to a limited degree, but inherent program subsidies and industry practices constrain the effectiveness of this link.

Straw Man Policy Options:

- **Municipal-level Insurance Model:** The Federal Government would identify flood risk, provide guidance to manage that risk, and offer insurance against flooding across a municipality.
- **Cap and Trade Model:** The Federal Government would identify the flood risk and loss caps per State, and provide flood disaster aid to States that comply with Federal flood risk caps. States manage their flood risk individually.
- **Watershed-based Insurance Model:** Every property is actuarially rated across the watershed and all communities within the watershed receive an annual insurance bill reflecting their shared risk.
- **State-based Regulatory Insurance Model:** States would design their own flood programs. The design could be left entirely to the State, with the Federal Government only setting minimum standards for benefits paid to property owners after a loss, or the Federal Government dictating one or more frameworks for delivery.

Rethinking the NFIP: Straw Man Policy Options

Federal Assistance Policy Options

Description of Policy Theme:

Do you benefit from floodplain use and development?

This straw man policy alternative explores how best to distribute the costs of using the floodplain. The Nation's losses due to flooding have been estimated to average over $7.7 billion annually (in 2009 dollars). The Federal Government pays a significant portion of these costs through Federal disaster assistance programs, including Individual Assistance (IA), Public Assistance (PA), and claims against flood insurance policies that are sold at subsidized rates. The National Flood Insurance Program (NFIP) was created by Congress in 1968 to help the individual bear more easily the risks of flood damage and to discourage unwise occupancy of flood-prone areas. It has partially accomplished both goals, but not sufficiently. Reform of both the NFIP and the Robert T. Stafford Disaster Relief and Emergency Assistance Act is necessary to reduce the ever increasing costs associated with flooding.

This paper presents four propositions for changes in national flood policy that are intended to reduce the costs to individuals, businesses, and the Federal Government associated with flooding, in exchange for individuals and communities assuming a greater share of the responsibility for their actions.

Straw Man Policy Options:

- **Federal Disaster Assistance and Mitigation Program:** Federally-backed flood insurance would be replaced by expanded eligibility for disaster assistance. Federal tax-payers, rather than the individual at risk, would explicitly assume the costs of flooding. Federal assistance would be made available to individuals, businesses, and public entities for flood damages experienced. To encourage flood risk management, the extent of the available assistance, or the cost-share ratio, would be tied on the level of mitigation measures implemented by the community. The more rigorous the mitigation measures the greater the percentage of damages eligible for compensation through disaster grants and loans. Conversely, where a community would adopt and implement only minimal flood loss reduction measures, eligibility for Federal disaster assistance would be more limited.

- **Restrict Federal Investment in Floodplains:** It is alleged that the mere availability of flood insurance has prompted development in flood-prone areas. Under this proposition, flood insurance would only be available through the Federal Government for structures built prior to a specific date. For example, any building constructed beginning 10 years after enactment would be ineligible for flood insurance under the NFIP. Further, structures built beginning 10 years after enactment would not be eligible for disaster assistance grants or loans.

- **Individual Accountability Model:** This proposition ties disaster assistance loans and grants directly to structures that are insured under the NFIP, but provides a mechanism to waive the mandatory purchase requirement. The most contentious part of the NFIP is the mandatory-purchase requirement which, in most cases, is made known to home buyers during the closing process. Lenders do not like it, buyers do not like it and, even though it is required by law, often lenders are not making sure the policies are renewed. This proposition would allow FEMA to waive the requirement to purchase flood insurance where an individual agrees, in writing, to also waive their rights to disaster assistance.

- **Universal Coverage:** This proposition would create mechanisms for States to mandate that insurers include flood as a covered peril under standard property insurance policies. Where policies are placed on properties within the Special Flood Hazard Area (SFHA) the Federal Government would underwrite the risk. For policies placed on property outside the SFHA private insurers would underwrite the risk. All communities within those States that fail to mandate coverage for flood would be ineligible to participate in the NFIP. As an added incentive, disaster assistance grants and loans would be denied for flood damages. This proposition would have the added benefit of drastically reducing the number of Letter of Map Amendment (LOMA) and Letter of Map Revision – Based on Fill (LOMR-F) applications.

Rethinking the NFIP: Straw Man Policy Options

National Flood Insurance Program - Optimization of Current Program Policy Options

Description of Policy Theme:

Don't throw the baby out with the bath water…

This straw man policy option seeks to make enhancements to the existing program to address programmatic weaknesses and current challenges while maintaining the current National Flood Insurance Program (NFIP) framework. The NFIP has succeeded in many ways to reduce flood risk across the United States since its inception in 1968. After 42 years, there are many concerns about the effectiveness of the NFIP. Now is the time to understand these concerns, then develop and adopt new aspects of the program to address these concerns to ensure future reductions in flood risk for the Nation.
Legislative, regulatory, and other necessary improvements to the current program have been considered to address stakeholder concerns. Potential improvements have been organized by the four basic components of the current program: insurance, floodplain management, flood hazard mapping, and incentives to mitigate flood risk.

Straw Man Policy Options:

- **Continue Current Program**
- **Abandon the NFIP**
- **Optimize the Current Program (while maintaining its fundamental structure)**
    - Insurance Improvements
        - Actuarial Soundness. Eliminate all flood insurance subsidies, or at least for non-residential and non-primary residence, when ownership transfers; charge actuarial rates for repetitive loss properties; remove the annual limitation on premium increases; forgive NFIP debt
        - Address Insurance Affordability. Establish a social program outside of the NFIP; abolish the mandatory purchase requirement; phase-in rate increases for newly identified or changed flood hazards
        - Improve Insurance Coverage. Provide higher coverage limits; require mandatory purchase of risk-based flood insurance in leveed areas; provide long-term flood insurance
    - Improving Floodplain Management
        - Strengthen Floodplain Management Standards. Establish one foot (or more) of freeboard as a minimum standard in 44 C.F.R. § 60.3; strengthen minimum floodplain management requirements; protect critical facilities to the 500-year flood; allow communities to use replacement cost in lieu of market value for determinations of substantial damage; decouple the Letter of Map Revision – Based on Fill (LOMR-F) process from the mandatory purchase requirement
        - Address Environmental Concerns. Do not insure new construction or substantial improvements in critical habitat areas mapped by other Federal Agencies
        - Identify and Regulate Additional Hazard Areas. Map and regulate coastal AE zones

- Flood Hazard Identification and Mapping
  - Levees and Infrastructure. Improve flood risk communication relative to levees; certify levees to specific level of protection; develop new flood zones specific to leveed areas; map residual risk associated with levees, dams, and other flood control structures
  - Science and Engineering. Map future conditions; establish arbitration panel to resolve map appeals; provide multiple frequency data for improved insurance rating, grants assessment, floodplain management, and implementation of Executive Order 11988; deliver flood depths based on quality terrain data for improved insurance rating and better flood hazard communications
  - Outreach. Require a community to perform outreach to citizens at the beginning of the study and mapping process; assist communities with economic impact analyses
- Incentives to Mitigate Flood Hazard
  - Alignment of Grant Policies. Unify NFIP-funded flood mitigation grant programs; eliminate statutory funding limits; align statutory language regarding cost-effectiveness for National Flood Insurance Fund (NFIF)-funded programs to direct the Federal Emergency Management Agency (FEMA) to prioritize funding for projects that demonstrate a savings to the fund; align Federal cost-share allowance to reflect FEMA's mitigation priorities; align valuation methodology and housing payment across NFIF-funded programs; direct FEMA to provide annual savings to the fund report for NFIF funded grant programs
  - Grant Eligibility. Eliminate flood mitigation planning as a standalone activity eligible for funding since support for multi-hazard mitigation planning is available under Robert T. Stafford Disaster Relief and Emergency Assistance Act authorities; provide Severe Repetitive Loss funds to non-residential properties; eliminate statutory characterization of technical assistance grants; align eligible activity types across NFIF funded programs; revise mitigation planning approach and connectivity with grant programs
  - Furthering Insurance Credits. Provide funds to communities for implementing Community Rating System (CRS) creditable activities; institute a sliding non-Federal cost share for disaster assistance and Water Resource Development Act projects, depending upon a CRS rating; expand community rating designations; expand promotion of CRS

Rethinking the NFIP: Straw Man Policy Options
Privatization Policy Options

Description of Policy Theme:

Is there a new role for the private sector?

There are various alternatives for turning to the private market to address flood losses including privatization of the entire program or privatization of elements of the program (enforcement, risk identification, mitigation, insurance). We recognize that the exact approach or solution for each alternative will depend upon the market's willingness and capability to assume a particular role. Until robust dialogues are held with relevant market players, a truly feasible solution cannot be clearly defined. Nevertheless, we offer some options to provide a flavor on how the alternative could be implemented.

One of the drivers for the enactment of the National Flood Insurance Act (NFIA) and establishment of the National Flood Insurance Program (NFIP) was the failure of the private market to provide any substantive means, by insurance or otherwise, to mitigate the flood hazard risk. Many hurdles stood in the way at the time: the areas prone to flood hazard and the likelihood of flooding had not been identified, building practices and codes that mitigate the flood hazard were not known or not enforced, and the financial risk of insuring properties with the potential for large catastrophic loses posed an unmanageable threat to the solvency of insurers. Now, 40 years later, many of these barriers have been addressed. The Federal Government has produced updated flood hazard data for more than 92 percent of the Nation's population, more than 21,000 communities adhere to minimum building and land use criteria, and various financial instruments could be explored that could help manage insurers' risks such as disaster bonds and auctioning risk. We must ask ourselves, is it possible for the private sector to pick up from where we are now and provide a better solution to the problem of flood losses?

Straw Man Policy Options:

- **Full Privatization:** The Federal Government would not be involved at all in the servicing and backing of flood insurance. The private market is left to enforce land use and building practices and mitigation would be funded by private markets. Federal disaster policy may be used to ensure future publicly funded disaster recovery occurs only in locations where minimum standards are implemented.

- **Privatize with Federal Assistance:** Full privatization may not be feasible if the private sector is unwilling or unable to assume all aspects necessary to mitigate the flood hazard effectively for the Nation as a whole. However, many of the functions of the existing NFIP could be moved completely to the private sector with the Federal Government's role reduced to providing guidance, setting minimum standards, and offering incentives (including financial backing).

- **Federal Role Limited to Special Classes of Population:** Under this option, the private market delivers all aspects of floodplain management including insurance, risk analysis, and building standards. The Federal Government's role is limited to those situations where intervention is deemed necessary to address market failures adversely affecting special classes of populations such as low-income populations or populations in particularly hazardous areas.

- **Reinsurance:** The Federal Government assumes a catastrophic loss reinsurer role where reinsurance is triggered by a loss amount or a particular flood disaster size. In the alternative, the Federal Government may sell the first line of flood insurance and pay a reinsurance premium to the private sector to take on losses exceeding a loss amount or based on a particular flood disaster size.

- **Financial Instruments:** Regardless of the policy alternative chosen for the NFIP Reform initiative, private-sector financial instruments can aid in reducing the volatility of flood losses (flatten the payout curve) or raise money for flood mitigation, recovery, or insurance. Financial instruments can also help improve fiscal soundness and planning for flood loss so that limited borrowing or emergency aid is required in excess of annual budgets. Instruments include disaster bonds, auctioning of risks (derivatives), and investment of insurance float.