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The Reality of Flood Insurance Repayment

By Rade Musulin

In 1817 the British poet Samuel Taylor Coleridge coined the phrase “willing suspension of disbelief,” describing an audience’s acceptance of a story line that is not constrained by reality. It allows us to enjoy a story in which characters travel through time, tame dragons, or do other things that we know are not possible.

In Washington, this concept may explain how one could accept the notion that the National Flood Insurance Program (NFIP) will somehow, someday repay billions of dollars that it must “borrow” from the U.S. Treasury. [*Editor’s note: The Academy’s Casualty Practice Council sent a letter in early November to U.S. House leaders on pending legislation to reauthorize and revise the NFIP. See story below.]*

The NFIP experiences two types of operational years. Most years have “normal” floods such that the program takes in enough in premiums to pay claims, cover administrative costs, and pay interest on its debt to the Treasury. In some years, though, the program suffers large losses from megastorms like Katrina, Sandy, and Matthew—and now Harvey, Irma, and Maria—requiring it to borrow billions from Treasury to cover claims.

In theory, the NFIP would repay those loans out of excess premiums collected in “normal” loss years. That’s where the willing suspension of disbelief is required. Earlier this year, reports from the Congressional Budget Office, the Government Accountability Office, and the Academy—as well as testimony from NFIP’s parent organization, the Federal Emergency Management Agency—all concluded that there is nowhere near enough surplus cash flow in the program to repay the debt, even after all planned rate increases are fully implemented. Congress has been told repeatedly that premiums cannot be realistically raised high enough to pay off the loans at any time in the foreseeable future.

The Texas National Guard aids Houston residents in areas flooded from Hurricane Harvey in August

At the start of this year, the NFIP owed almost $25 billion to the Treasury and was incurring about $400 million per year in interest charges. Almost all this debt was attributable to Katrina (in 2005), Sandy (2012), and Matthew (2016). The NFIP had about $3 billion in unused borrowing authority available when Harvey, Irma, and Maria struck recently. Preliminary estimates of the losses from those storms to property insured by the NFIP are around $20 billion.

Instead of raising the NFIP’s statutory borrowing limit of $30 billion, the Trump administration instead proposed forgiving $16 billion of existing debt. In emergency disaster relief legislation passed in October, Congress agreed. This meant that the $20 billion in new debt could be accommodated within the $30 billion limit. If another big storm comes along, presumably the same accounting method could be used again.

Eventually, the NFIP will owe the Treasury $30 billion and its annual interest payment will be well above $400 million per year. Meanwhile, premium income (before fees and surcharges) will remain at about $3.5 billion per year. Repayment of the debt in full is about as likely as our personally experiencing time travel or taming dragons.

When the Academy’s Flood Insurance Work Group issued its analysis of the NFIP in April, we suggested several reforms that Congress could consider. Important principles behind those ideas were to recognize that past debt cannot be repaid by the NFIP under any reasonable scenario, that repayment of additional losses from new megastorms needs to be carefully considered, and that Congress should adopt a long-term perspective, much the same way it looks at Social Security and Medicare.

Planning for repayment of the NFIP debt and future losses will require Congress to recognize the extreme levels of damage and costs associated with megastorms, beyond “typical” losses that are covered by premium income and above a modestly higher level of losses that can be covered by commercial reinsurance contracts. This recognition is found in other property insurance programs where we see that state-run risk pools for catastrophic wind storms or earthquakes have the power to levy assessments. It is how residual markets operate for automobile insurance. It is how guaranty funds work in the case of insolvencies.

We cannot expect the relatively small pool of flood insurance policyholders to repay a debt that is more than eight times as large as the annual premium base. Decisions and acceptance of a threshold beyond which megastorm losses become a general public responsibility—along with a plan for financing NFIP losses up to that threshold—are politically difficult but necessary.

Such planning is entirely feasible. The Academy’s study offered several ideas, including expansion of private coverage for flood; increased use of commercial reinsurance; reduced exposure to repetitive losses; improved mitigation; and planning for foreseeable changes in future flood risk, including the effects of sea level rise on non-storm coastal flooding. Long-term thinking is critical with respect to building codes, because today's decisions on how we build in high-risk areas will affect the NFIP's finances for decades to come.

We can and should address these realities that challenge the NFIP. Otherwise, we will have to again suspend disbelief, stop worrying about the NFIP's unpaid debt, ignore the problem of megastorms, and continue building as usual. Can future generations of taxpayers afford that?

Rade Musulin is an actuary in Gainesville, Fla. This article is solely the opinion of its author. It does not express the official policy of the American Academy of Actuaries; nor does it necessarily reflect the opinions of the Academy's individual officers, members, or staff.

CPC Comments on Flood insurance Legislation

The Casualty Practice Council (CPC) sent a letter Nov. 8 to the U.S. House of Representatives offering comments on H.R. 2874, the revised *21st Century Flood Reform Act*, which would revise and reauthorize the National Flood Insurance Program (NFIP).

"A number of important reforms are in the bill as it is written, but more can be done to aid flood risk assessment and mitigation, and help address the NFIP's sustainability," said Rade Musulin, the Academy's vice president, casualty.

CPC's letter offers a series of recommendations, including:

- Renew the NFIP for at least five years, as it has been in the past;
- Encourage growth of the private insurance market, which would offer more consumer choice;
- Avoid pricing disparity and funding problems;
- Resolve the NFIP's debt question, given its current debt to the U.S. Treasury approaching $30 billion;
- Address repetitive loss properties;
- Make more historical flood loss data available;
- Modernize flood mapping and risk assessment;
- Change the mitigation program;
- Align coverages between NFIP and private insurance policies; and
- Take into account rising sea level.

Annual Meeting and Public Policy P/C Sessions Cover Flood, Auto Insurance

Property/casualty sessions at the Academy's Annual Meeting and Public Policy Forum, held Nov. 14–15 in Washington, D.C., covered flood and automobile insurance, and included a preview of the 2018 state and federal legislative and regulatory landscape. See the upcoming November *Actuarial Update* for more coverage.

Academy Names Kevin Ryan Senior P/C Fellow

Kevin M. Ryan, an actuary with decades of regulatory, executive, and consulting experience, was named the Academy's new senior property and casualty fellow. Ryan, whose appointment was effective Sept. 1, succeeds Jim MacGinnitie, who retired in September.

In his role, Ryan will communicate the Academy's work on casualty actuarial issues pertaining to cybersecurity, extreme weather and catastrophic event risks, workers' compensation, medical professional liability, reinsurance, automobile insurance, and many more casualty issues to the public and to public policymakers.

"The actuarial profession has a unique capacity to educate the public and assist in establishing sound public policy," Ryan said. "I welcome the opportunity to be a voice for the profession in this important work."

A past Academy treasurer, Ryan served early in his career as deputy director of the Illinois Department of Insurance, where he initiated early-warning solvency testing programs, a precursor to risk-based capital. He assisted in the formation of the Insurance Services Office, merging independent fire rating bureaus into the fledgling organization, later serving as vice president, commercial lines. He served as president of the National Council on Compensation Insurance for 10 years.

A past president of the Casualty Actuarial Society, Ryan was a partner at and established the East Coast casualty consulting practice for Milliman, and was later a partner at Bickerstaff, Whatley, Ryan & Burkhalter.

Legislative/Regulatory Update

Following is an update of key federal and state property/casualty legislation, including flood insurance proposals, as well as regulatory actions.

Federal Flood Insurance Legislation

In the wake of hurricanes Harvey, Irma, and Maria in August and September, Congress continues to work on reauthorizing and revising the National Flood Insurance Program (NFIP) before statutory authority for the program expires on Dec. 8. H.R. 2874, the *21st Century Flood Reform Act*, passed the U.S. House of Representatives on Nov. 14 by a vote of 237-189. The bill would reauthorize the NFIP for five years, increase the role of private insurers in the flood insurance market, and improve tools and data used to develop accurate estimates of flood risk. See the Academy alert for more information.

Other Federal Activity

- President Trump signed H.R. 2266 into law on Oct. 26. Among other disaster relief measures, the law canceled $16 billion of the debt held by the NFIP in order to allow new borrowing to pay claims from the summer hurricane season. The legislation did not make any revisions to the NFIP. Read the Academy Alert here.
- The Department of Transportation released revised guidelines for self-driving cars on Sept. 12. The guidelines include safety elements, clarification of federal and state legislative and regulatory roles, and best practices for state legislatures and highway safety officials.
- A bill to address the regulation of self-driving cars passed the House on Sept. 6. The bill, H.R. 3388, if passed by the Senate and signed into law by the president, would be the first-ever law of its kind in the U.S. Read the Academy Alert here.
- The president signed an executive order on Aug. 24 ending a requirement that federally supported infrastructure projects located in flood zones take rising sea levels into account.

State P/C Legislative Activity

Many state legislatures considered P/C insurance legislation in the past quarter, including several on automobile insurance.

- The Michigan state House of Representatives in November rejected H.B. 5013, which would have allowed auto insurance plans with lower personal injury benefits than are currently available under the state's no-fault system.
- The Supreme Court of Oklahoma ruled a state law concerning medical negligence suits unconstitutional in October. The law in question required the dismissal of medical negligence cases from plaintiffs who fail to file expert affidavits attesting to the merits of their cases.
- Two auto insurance bills were pre-filed for the 2018 session in the Florida State Senate in October. S.B. 410 would prohibit the use of a ZIP code or collection of ZIP codes in determining auto insurance rates. S.B. 414 would prohibit the use of credit scores in auto insurers' decisions regarding policyholders and applicants and in the determination of auto insurance rates.
- S.B. 258, pre-filed in the Florida State Senate in September, would prevent the inclusion of attorneys' fees paid under the state's workers' compensation laws in insurers' rates or rate changes.
- S.B. 150, pre-filed in the Florida State Senate in August, would repeal the Florida Motor Vehicle No-Fault Law, revise requirements for a motor vehicle liability policy that serves as proof of financial responsibility for certain operators or owners, and require specified motor vehicle liability insurance policies to include medical payments coverage.
- H.B. 97, also pre-filed in the Florida House in August, would revise reimbursements to insurers from the Florida hurricane catastrophe fund and authorize temporary rapid cash build-up factors if the fund balance drops below a certain amount, as well as authorize the fund's board to direct the Florida Office of Insurance Regulation to levy an emergency assessment on specified premiums to address certain deficits in the fund.

- Delaware Gov. John Carney signed a bill into law in August that sets permissible uses of credit information in rating personal insurance and prohibits insurers from using factors such as age and marital status, among others, to determine an insurance rate.

State Regulatory Activity

- The Nevada Department of Insurance proposed an amendment to a rule in October relating to total loss settlements for automobiles. Specifically, the amendment calls for the use of a price guide of used vehicles approved by the commissioner of insurance to determine the valuation of a used automobile.
- The Texas Department of Insurance adopted an emergency rule in September that provides extensions for deadlines for the process of handling claims filed under a Texas Windstorm Insurance Association policy.
- The New York Department of Financial Services adopted a rule in August providing guidelines for Statements of Actuarial Opinion by property and casualty insurers.

Reserve Your Copy—2017 P/C Loss Reserve Law Manual

The latest edition of the *Property/Casualty Loss Reserve Law Manual* is available for order. With delivery by early January, the manual is designed to help appointed actuaries comply with NAIC Annual Statement requirements for Statements of Actuarial Opinion (SAOs).

The new edition has improved navigation and contains essential information for actuaries, including: SAO requirements and the laws and regulations establishing those requirements for every U.S. state, Washington, D.C., and Puerto Rico; annual statement instructions for the SAO for property/casualty, title loss, and loss expense reserves; and other pertinent annual statement instructions.

The manual is available both online and on CD-ROM. Reserve your copy today.

ACI Value Reaches New High With Winter 2016–17 Data

Quarterly data for the Actuaries Climate Index (ACI), released in October, shows extreme weather events continue to increase across Canada and the United States, with the index value reaching a new high in winter 2016–17.

ACTUARIES CLIMATE INDEX
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The new ACI data showed a record high followed the previous record value measured in fall 2016, reflecting increasing incidence and severity of weather extremes and sea level rise from historically expected patterns for the two countries.

“The severity of this year’s hurricanes and wildfires has highlighted the question of whether extreme weather is increasing, and the ACI data continues to trend upward for most North American regions,” said Stuart Mathewson, Academy Board member and member of the ACI’s Climate Change Committee.

“The record value for the index (which is a five-year moving average) was driven by the values for the last six seasons,” he said. “These seasons all have had index values over 1.50, compared to the years before 1998, when there was no season over 1.00. We have seen more extreme weather events than one would expect based on the benchmark climate data.”

Along with the Academy, the ACI is sponsored by the Canadian Institute of Actuaries, the Casualty Actuarial Society, and the Society of Actuaries.

CLRS Sessions Feature Academy Presentations

More than 500 people attended the Casualty Loss Reserve Seminar (CLRS) in Philadelphia in September, which was co-hosted by the Academy and the Casualty Actuarial Society. A number of Academy volunteers were on the faculty for this year’s CLRS program.

Kathy Odomirok, vice chairperson of the Committee on Property and Liability Financial Reporting (COPLFR), led a discussion about the Academy’s P/C loss reserves practice note, and COPLFR gave a preview of a draft of a practice note, *Retained Risk for Non-Insurers: Accounting Treatments and Perspectives*, which is scheduled to be released for comment later this year. The COPLFR presentation was given by Chairperson Lisa Slotznick along with Patty Smolen, Tom Conway, and Mary Frances Miller, a past Academy president.

Post-NAIC Webinar Examines Casualty Issues

The Casualty Practice Council’s Sept. 6 webinar, “P/C Post-NAIC Update—Summer 2017,” reviewed recent NAIC developments of interest to casualty actuaries. Topics included the data call to statistical agents to examine automobile insurance rates and availability, and the proposed creation of a predictive analytics team to help states evaluate complex rate filings. Also discussed were a review of changes in underwriting risk factors, risk-based capital (RBC) requirements, and proposed changes in corporate bond factors for investment RBC.

The National Flood Insurance Program was given a short-term extension to Dec. 8—from Sept. 30—and attendees also heard a report on various plans to reauthorize and reform that program.

Presenters were Committee on Property and Liability Financial Reporting Committee Chairperson Lisa Slotznick, P/C RBC Committee Chairperson Lauren Cavanaugh, and Iowa regulator Ramona Lee. Rade Musulin, vice president, casualty, moderated. Slides and audio are available free to Academy members.