



Under Water: The U.S. National Flood Insurance Program Reauthorisation

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The U.S. National Flood Insurance Program is due to expire this year. As Congress currently carries out the reauthorisation process, Rade Musulin, Vice President of Casualty of the American Academy of Actuaries and CEO of FBAlliance Insurance, tells us about the program and discusses reforms Congress is considering for the future.

The mechanism for providing flood coverage is very different in the United States than Australia. While Australians have generally been able to secure coverage for many types of flood from private insurers without significant government involvement, in the US most flood coverage for homeowners and small businesses is provided by the National Flood Insurance Program (NFIP), a government program directed by the Federal Insurance and Mitigation Administration of FEMA, which is part of the U.S. Department of Homeland Security. The law authorizing the NFIP is set to expire on September 30, 2017, so Congress is in the midst of what promises to be a contentious reauthorisation process.

In recent decades, the NFIP has incurred almost A\$32 billion of debt to the US Treasury, largely due to huge losses from Hurricane Katrina and Superstorm Sandy. It borrowed an additional A\$1.8 billion in 2016, largely to cover losses from a tropical rain system affecting Louisiana and Hurricane Matthew. This has prompted calls from fiscal conservatives in Congress to reform the program, as it is unlikely to be able to repay its debt as it is currently structured.

The NFIP insures over 5 million policies generating about A\$4.5 billion in annual premium. It was formed in 1968 to address significant problems with availability and affordability of flood coverage from private insurers. In the US almost all private insurance policies in homeowners exclude coverage for rising water of any type, in contrast to Australia where most policies provide at least some coverage. US consumers wanting flood coverage generally must buy a separate policy from the NFIP, which has designated “high risk” zones where mortgage lenders generally require a flood policy to be purchased. Overall, only about 10% of homeowners buy policies (much higher in the high risk zones), leaving many without coverage when flooding occurs.

Significantly, NFIP dwelling coverage is limited to about A\$325,000 on a replacement cost basis, contents coverage is limited to about A\$130,000 on an actual cash value basis, and coastal storm surge is covered. In Australia coverage is usually for the replacement value of the dwelling, replacement cost contents is available, but coastal storm surge is not covered. It is argued that the existence of government flood coverage for beachfront property in the US has encouraged overdevelopment in high risk areas. Large losses from tropical cyclones have driven the NFIP's debt, and if predictions of rising sea levels materialize in coming decades the program's financial exposure could be enormous.

Congress is considering many reforms, including increasing premiums, encouraging the use of reinsurance, and pushing privatization. Various stakeholders, including local communities, consumer groups, realtors, and builders are resisting changes that may impede development or hurt property prices.

There are several actuarial aspects of the reauthorization debate, which has prompted the American Academy of Actuaries to produce a monograph on the NFIP that will be released shortly. The monograph offers a comprehensive look at issues surrounding the program, including its history, how it interacts with other government functions (like the development of building codes), how it is funded, its sources of capital for extreme events, recent developments in flood modeling, how rising sea levels may affect the program, how actuarial standards and principles can inform ratemaking, and potential issues with privatization. While the Academy does not take advocacy positions for or against specific policy proposals, the monograph does offer a number of observations on various ideas that have been advanced to modify the program. The monograph will be available from the Academy's website, www.actuary.org (<http://www.actuary.org>), around 1 April.

Policy makers in Australia have on occasion considered actions to address perceived market deficiencies for catastrophic coverage, such as the recent Northern Australia Insurance Premium Taskforce. The US experience with flood insurance offers valuable lessons in how policy initiatives can affect economic activity, government finances, and the insurance system.

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