The Daily Dish

Hurricane Harvey Highlights Critical Need for Flood Insurance Reform

MEGHAN MILLOY | AUGUST 31, 2017

Eakinomics: Hurricane Harvey Highlights Critical Need for Flood Insurance Reform

When Hurricane Harvey's flood waters finally recede, millions of Americans will begin the long and expensive clean-up and rebuilding process. For many, the first step will be contacting the Federal Emergency Management Agency's (FEMA) National Flood Insurance Program (NFIP) to make a claim on their flood insurance policy.

The NFIP, the primary underwriter of flood insurance in the United States, was established in 1968 to mitigate flood risk through flood zone mapping and to provide affordable flood insurance for at-risk properties. After Hurricanes Katrina and Rita left the program $19 billion in debt, Congress passed the Biggert Waters Act which increased premiums and reassessed the flood zone maps in an effort to make premiums more actuarially sound. Later that year, Superstorm Sandy struck the East Coast, putting the NFIP over $23 billion in debt. A Government Accountability Office (GAO) study from earlier this year shows that the program owes at least $24.6 billion, which GAO predicts FEMA will be unable to repay.

The NFIP's current authorization expires at the end of September. This provides Congress an opportunity to make several structural reforms to help get the program out of debt – which will, no doubt, increase dramatically in the aftermath of Harvey – prevent it from going back into debt, and continue to make affordable flood insurance available to those who need it. Among many others, there are three relatively simple fixes that Congress could make to keep the NFIP afloat: 1) Promote and enforce policyholder compliance; 2) Charge premiums that accurately reflect the risk; and 3) Share the risk with the private market.

When the last NFIP compliance study was completed, only about 53 percent of structures in Special Flood Hazard Areas (SFHAs) that were required to have flood insurance actually had it. Since then, the number of NFIP policies in force has continued to drop, with fewer than 5 million covered properties as of May 2017. The fewer properties that are covered means fewer premiums paid into the program and more unexpected, large payouts from FEMA (and from taxpayers) after a disaster. Congress should prioritize having the most at-risk properties come into compliance with the NFIP.

Several studies have found that premium rate subsidies are a main cause of the NFIP's massive debt. GAO has said, "NFIP premiums do not reflect the full risk of loss which increases the federal fiscal exposure…, obscures that exposure from Congress…, and discourages private insurers from selling flood insurance (they cannot compete on rates)." By charging rates that reflect the full risk, stakeholders would better understand the risk and the exposure and would encourage private sector involvement. Congress could offset higher rates with other need-based aid.

Last, the NFIP should share risk with the private market. Not unlike proposals to share the risk of subprime mortgages with private mortgage insurance, FEMA could reduce its and taxpayers' exposure to flood risk through increased participation by private flood insurance. Not only does this reduce the NFIP's risk, but it allows the government to focus on flood risk mitigation and emergency aid. The correlated nature of flood risk makes the possibility of a totally private flood insurance market unlikely, but there are a number of public/private risk sharing options that would work. For example, the NFIP could serve as an insurer or reinsurer of last resort or could provide primary insurance focused solely on residual market risks left over from what the private insurers could not underwrite. In any case, Congress should encourage private market entrants to flood insurance through the elimination of non-compete clauses and premium rate subsidies.