Biggert-Waters Flood Insurance Reform and Modernization Act of 2012

The Bill and the Aftermath

CASE Spring Meeting
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Stuart Mathewson, FCAS, MAAA, CPCU
Sr. Property Actuary, Swiss Re
Former Chair, AAA Flood Subcommittee

Agenda

- Flood Insurance – NFIP
- AAA Involvement
- Biggert-Waters
- Other Issues
- Reactions to Biggert-Waters
- Questions and Answers

Flood Insurance – National Flood Insurance Program (NFIP)

- Property insurers determined long ago that flood was not insurable
- In 1968, Congress passed an act to establish NFIP
- By 1973, most communities were up and running
- Some key points
  - Flood insurance available only in communities that established mandated controls
  - Buildings built before establishment of flood maps were charged subsidized rates
  - Program needs to be re-authorized periodically
  - Later laws mandated insurance for properties with federally insured mortgages

Flood Insurance – National Flood Insurance Program (NFIP)

- Full-risk ("actuarial") rates vs Subsidized rates
  - Full-risk
    - Loss costs based on hydrological model
      - Loss + LAE = 63.3 % of premium
      - If losses follow historical average of 43.8%, there will be a 10% contribution to Debt/Surplus and 6.7% repayment of interest on debt
    - Expenses
      - WYO Allowance = 27.4%
      - Other operating expenses = 9.1%
    - Target Level Premium –total premiums balanced to long term loss experience
    - 78.5% of policies per 2011rate review

Flood Insurance – National Flood Insurance Program (NFIP)

- Full-risk ("actuarial") rates vs Subsidized rates (cont.)
  - Subsidized
    - Pre-FIRM structures ~pre 1975
    - Special post-FIRM Classes
      - In zone A99, but structural measures to protect are at least 50% completed
      - Zone AR – structural measures have been decertified, but restoration is scheduled
      - In V zones – structures built 1975-1981 for flood, but not waves
      - Subsidies as much as 50%+
    - 21.5% of policies per 2011 rate review

Flood Insurance – National Flood Insurance Program (NFIP)

- Annual Actuarial Rate Review
  - In Support of the Recommended Rate and Rule Changes
  - Very good source for background information on NFIP as well as the details of the rate review
  - Latest on web is October 2011

Flood Insurance – National Flood Insurance Program (NFIP)

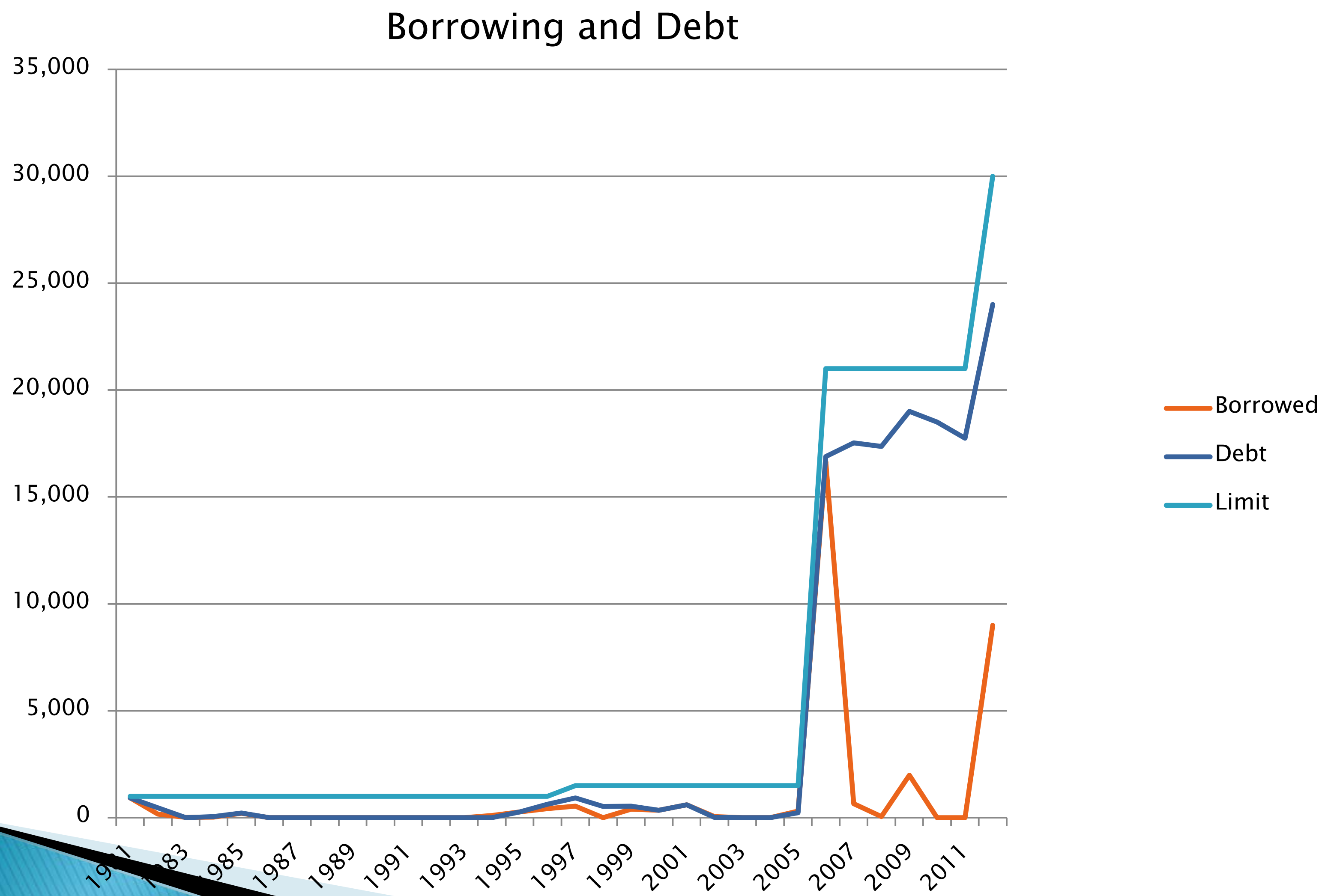
- Intent is that program be self sufficient
- In years that losses and expenses exceed premiums, NFIP can borrow from Treasury
- Until 2005, borrowing limit was $1.5b
- After Katrina, limit was raised to $21b
- After Sandy, limit was raised to $30b
- Current debt is $24b
- Current annual premiums about $3.5b

Flood Insurance – National Flood Insurance Program (NFIP)

20 Largest NFIP Losses

Rank	Event	Date	Loss ($m)
1	Hurricane Katrina	Aug. 2005	16,265
2	Sandy	Oct. 2012	8,000
3	Hurricane Ike	Sept. 2008	2,664
4	Hurricane Ivan	Sept. 2004	590
5	Hurricane Irene	Aug. 2011	1,302
6	Tropical Storm Allison	Jun. 2001	1,104
7	Louisiana Flood	May 1995	585
8	Hurricane Isabel	Sept. 2003	493
9	Hurricane Rita	Sept. 2005	473
10	Hurricane Floyd	Sept. 1999	462
11	Tropical Storm Lee	Sept. 2011	442
12	Hurricane Opal	Oct. 1995	406
13	Tropical Storm Isaac	Aug. 2012	407
14	Hurricane Hugo	Sept. 1989	376
15	Hurricane Wilma	Oct. 2005	365
16	Nor'Easter	Dec. 1992	346
17	**Midwest Flood**	Jun. 1993	273
18	**PA, NJ, NY Floods**	Jun. 2006	229
19	**Torrential Rain – TN**	Apr. 2010	228
20	Nor'Easter	Apr. 2007	226

Flood Insurance – National Flood Insurance Program (NFIP)



Brief background – AAA involvement

- Previous Flood authorization expired in 2008
- AAA Extreme Events Committee started work on paper to address flood issue
- Congress took 5 years – and numerous short-term authorizations to pass new law
- *The National Flood Insurance Program: Past, Present…and Future? – 2011*
  - Purpose was to educate on the Flood program to aid in the public discourse
  - Primary audiences
    - Actuaries
    - Decision makers

Brief background – AAA involvement

- Capitol Hill briefing on monograph (July, 2011)
- Comment letters and written testimony to Congress when deliberations were ongoing (e.g., 6/28/12)
- Presentations to NCOIL and NAIC (2011,2012)
- Comment letters concerning the House and Senate bills, 2013 and 2014

Biggert-Waters Flood Insurance Reform and Modernization Act of 2012

- Phased out subsidies for 2nd homes, businesses and severe repetitive loss properties (25%/year)
- **Any policy for property not currently covered, or newly owned, must pay "actuarial" rates**
- **Major increases for properties where mapping has changed the risk**
- Raised cap on annual increases from 10 to 20%
- Set up reserve fund
- Required NFIP to set up a schedule to repay debt
- Required several studies by GAO, Treasury and others

Biggert-Waters Studies/Issues

- Privatization
  - Why was flood deemed uninsurable?
    - Only those who would often get flooded were interested in buying it
    - Premium for those properties alone would be prohibitive
    - Small premium base wouldn't support catastrophic potential

Biggert-Waters Studies/Issues

- Privatization
  - Do past issues still exist?
    - Current situation
      - No one stepping in to profit from this niche
      - Some companies offer excess coverage on high valued properties
      - Large commercial properties usually covered in all-risk policies
    - Few buy NFIP insurance unless forced
      - And, enforcement not consistent when mandated

Biggert-Waters Studies/Issues

- Privatization
  - Do past issues still exist?
    - Can new technologies help?
    - Wharton/CoreLogic Study
      - *A Methodological Approach for Pricing Flood Insurance & Evaluating Loss Reduction Measures: Application to Texas*

Biggert-Waters Studies/Issues

- Privatization
  - Can it be properly rated? And would those rates be sustainable in the market?
    - Expected Losses can be estimated by models
    - Much more granular rating than NFIP
    - NFIP has no capital requirements – therefore, no capital cost load – private companies would need a significant load
    - An estimate has been made that rates would have to be roughly doubled if written privately
  - Can it develop a broad base?
    - Without a mandate, it's hard to foresee increase in take-up rates

Biggert-Waters Studies/Issues

- Reinsurance or Capital Markets
  - Can these mechanisms be used to support the NFIP?
    - At current rate levels, there is little premium to cover the cost of private reinsurers
    - Could Federal government act as reinsurer instead of simply a lender?
    - One idea – Federal government pays for private market reinsurance
      - Would provide a stable expense for the government
      - Private/Public partnership in vogue now for some
      - Politically viable?

Biggert-Waters Studies/Issues

- Reinsurance or Capital Markets
  - Can these mechanisms be used to support a private market?
    - This could be a key piece of privatization – but requires enough premium to pay for the reinsurance

Biggert-Waters Studies/Issues

- Should the Debt be Forgiven?
  - At current rate levels, it would take decades to repay debt – even without further major occurrences
    - After Katrina, about $20B
    - After Sandy, currently about $24B
  - Biggert-Waters requires FEMA to create a repayment schedule
    - Must submit to Congress a report on options to eliminate debt in 10 years

Biggert-Waters Studies/Issues

- Should the Debt be Forgiven?
  - Reserve
    - Required by Biggert-Waters
      - 1% of "total loss potential" in force
      - Fund at 7.5% of reserve ratio until capitalized
      - If NFIP unable to make the minimum contribution, it must report this to Congress
    - How is this to be paid for?

Reactions to Biggert–Waters

- Strong push–back to requirement for new owners or new policy holders to pay full risk rates
  - Some increases almost 10x
  - Hurting real estate markets
- Also, concern about re–mapping causing a move from Zone B or X to A, although FEMA has not implemented this yet

Reactions to Biggert-Waters

- Omnibus Spending Bill of 2014
  - Delays the implementation of increases for re-mapping until FEMA study of affordability or 4 years

Reactions to Biggert-Waters

- Grimm-Waters – Homeowner Flood Insurance Affordability Act of 2014
  - Annual rate increases limited to 15% on average for a class of properties, and 18% for individual policies
  - Repeals full risk rate trigger for new policies or new owners
  - Reinstates grandfathering for risks in areas where maps change
  - Refunds homeowners who overpaid
  - Affordability goal – FEMA to "strive" to minimize number of policies with premiums > 1% of coverage amounts
  - New assessments of $25 per year for homeowners and $250 per year for businesses and vacation homes

Reactions to Biggert-Waters

- The **Florida** legislature is looking at bills that would encourage the private market to write more flood
- **Rhode Island**, **South Carolina**, **Virgini**a and **Vermont** all have bills pending that would restrict lenders from acting adversely due to lack of flood insurance

Questions and Answers