TAXPAYERS FOR COMMON SENSE
MAKING GOVERNMENT WORK

Testimony of Steve Ellis
Vice President, Taxpayers for Common Sense

Subcommittee on Housing and Insurance
Committee on Financial Services
hearing
"Opportunities for a Private and Competitive Sustainable Flood Insurance Market"

November 19, 2014

Good afternoon, Chairman Neugebauer, Ranking Member Capuano, members of the subcommittee. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog. Thank you for inviting me here today to testify on H.R. 4558, the "Flood Insurance Market Parity and Modernization Act of 2014" and issues involving a private flood insurance market.

Background on the National Flood Insurance Program

After years of ad hoc disaster aid being meted out by Congress, the National Flood Insurance Program (NFIP) was established in 1968 to create "a reasonable method of sharing the risk of flood losses through a program of flood insurance which can complement and encourage preventative and protective measures."[1] The program was to make up for a lack of available flood insurance. But even at that time Congress was warned that it was playing with fire. The Presidential Task Force on Federal Flood Control Policy wrote in 1966:

> A flood insurance program is a tool that should be used expertly or not at all. Correctly applied it could promote wise use of flood plains. Incorrectly applied, it could exacerbate the whole problem of flood losses. For the Federal Government to subsidize low premium disaster insurance or provide insurance in which premiums are not proportionate to risk would be to invite economic waste of great magnitude.[2]

Well, we know which way that story unfolded. Although subsidies were largely envisioned to be limited and short-term, they weren't. And while the program has encouraged standards and

[1] P.L. 90-448.

[2] U.S. Task Force on Federal Flood Control Policy. "A Unified National Program for Managing Flood Losses." August 1966. P 17. http://www.loc.gov/law/find/hearings/floods/floods89-465.pdf

construction that help reduce flood risks for participating communities, the availability of subsidized federal flood insurance over the last several decades made it financially attractive to develop in high risk areas. Along with other factors, NFIP helped fuel the coastal development boom that increased the program's risk exposure and losses.

$24 Billion in Debt and Subsidized Rates

For years NFIP teetered on either side of solvency, covering shortfalls with Treasury borrowing and repaying the loans in years of surplus. Then in 2005, the inevitable happened – a catastrophic loss year – and the program was roughly $18 billion in debt to the Treasury. That was followed by the Superstorm Sandy losses in 2012 and now the program is more than $24 billion in debt to taxpayers. To put that in perspective, FEMA data indicates that in 2013 the 5.6 million policies resulted in $3.5 billion in premium to insure $1.3 trillion worth of property.[3] The Government Accountability Office has estimated that approximately 20 percent of policies are explicitly subsidized and paying only 35-45 percent of their actual full-risk level premiums.[4]

As this Subcommittee well knows, reforms to the NFIP were enacted in 2012 to increase premiums to more risk-based rates, which would not only help program solvency, but also help policyholders better understand their risk and take measures to mitigate that risk. Despite some concerns, TCS supported the 2012 legislation while also favoring additional efforts to help address affordability issues. Unfortunately, earlier this year Congress reacted to a vocal minority and largely rolled back the 2012 reforms that would have led to more actuarial rates.

Private Flood Insurance

To obtain a mortgage, property owners in designated special flood hazard areas (typically those with one percent chance of flooding in any given year) are required to purchase flood insurance. As long as it met NFIP coverage standards (enough insurance to cover property value or maximum coverage amount of $250,000, whichever is less) private flood insurance could be an alternative to federal flood insurance to meet the mandatory purchase requirement. As the shift to more risk-based rates under the reform neared, the private market started to strengthen. States like West Virginia and Florida enacted legislation to regulate new private flood insurance alternatives in their states.

However the 2012 flood insurance bill went further than before and attempted to quasi-regulate what exactly constituted private flood insurance by including a proviso that private flood insurance be "at least as broad" and essentially mirror an NFIP policy. This will result in lenders rejecting some private policies as not meeting legal requirements. For example, homeowner may want to purchase a higher coverage limit with a higher deductible than is available under the NFIP. Current law would result in that policy being rejected by the lender as not meeting the legislated "private flood insurance" definition.

---

[3] Federal Emergency Management Agency. Available at: https://www.fema.gov/statistics-calendar-year

[4] Government Accountability Office. "Flood Insurance: More Information Needed on Subsidized Policies." July 2013.

The whole point of allowing a private insurance alternative is to create competition and choice in the marketplace and reduce the possible burden on the taxpayer. Furthermore, insurance is regulated at the state level. The federal government leaves decisions on homeowners insurance and car insurance to states; they should do the same for private flood insurance alternatives.

This is why Taxpayers for Common Sense supports H.R. 4558, the “Flood Insurance Market Parity and Modernization Act of 2014.” This legislation would remove the restrictive and confusing language and define private flood insurance as an insurance policy that is issued by an insurance company that is licensed or approved in the State where the property is located. This does not remove the mandatory purchase requirement and minimum coverage level. This just allows insurance commissioners to regulate the product in their state the way it is done for other insurance lines. One recommendation that TCS has would be clarify that if a homeowner opts for uninterrupted coverage through a private policy, the homeowner should not be treated as having a 'lapse' in coverage under NFIP. This would allow a homeowner to return to the NFIP, if they desire, without penalty.

The only reason a policyholder will opt for private insurance over NFIP is because the private insurance offers a better product, a better price, or both. To stifle the private market would be akin to the federal government forcing policyholders to pay more.

Barriers to Private Flood Insurance

In addition to the definitional issue, the existence of subsidized federal flood insurance is a barrier to the development of a robust private market. Simply put, NFIP occupies the space where the private sector would operate. It is true that NFIP was created because there wasn’t a functioning private insurance marketplace, but that was nearly fifty years ago. It almost goes without saying that technology and modeling have advanced dramatically. Imagery and mapping technology has similarly developed. The reinsurance and financial instruments to manage risk are much larger and more diversified.

Many countries in the world have private flood insurance either bundled into property insurance or as separate or add-on coverage. These are typically backed by reinsurance. In fact, the U.S. is one of the only countries with a state-backed separate policy of flood insurance.[5]

Conclusion

The development of a private flood insurance market in the United States would serve to shift some of the post-disaster recovery and rebuilding burden from taxpayers to the private sector and those who choose to live in high risk areas. It could also be a powerful tool to encourage mitigation in the face of increased disasters and sea level rise. The National Flood Insurance Program is $24 billion in debt to the taxpayer. While the decision to repeal many of the 2012 reforms was a setback, Congress can enact H.R. 4558 to at least help private flood insurance have a chance.

[5] Jessica Lamond, Edmund Penning-Rowsell. Climate Risk Management. “The Robustness of Flood Insurance Regimes Given Changing Risk Resulting from Climate Change.” March 29, 2014.