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National Flood Insurance Program

The NFIP's mission. The objective of the National Flood Insurance Program is to provide affordable flood insurance to homeowners and businesses via licensed agents and insurance companies. Private insurers have generally avoided offering flood coverage, or have provided it at high prices. (Insurers are concerned about inherent risks of adverse selection, moral hazard, and concentration of exposure to catastrophic losses.) A second critical objective is to encourage local land management practices that reduce the probability and severity of flood damage.

NFIP

Insurance in Force: \$743.6 billion

Reserves: \$1.1 billion

Statutory Taxpayer Exposure*: \$3.5 billion

Budget Cost FY 2004: Nothing

*Note: Reflects total federal losses in a worst case scenario given current law and current financial commitments

The NFIP was established in 1968 to mitigate increasing taxpayer funded flood relief. Prior to the founding of the NFIP, many people could not buy flood insurance. As a result, the federal government often simply provided disaster assistance after a flood. This direct assistance was costly for taxpayers and did not cover many of the losses incurred. Aid was often paid out on multiple occasions in the same areas because rebuilding often ignored risk reduction measures.

Structure and Functions

Nuts and bolts. The National Flood Insurance Program is administered by the Mitigation Division of the Federal Emergency Management Agency (FEMA), part of the Department of Homeland Security. The Director of the Mitigation Division, who also acts as the Federal Insurance Administrator, heads the program. The NFIP's guidelines are set by Congress pursuant to 42 U.S.C 50, and it is overseen by the House's Financial Services committee and the Senate's Banking, Housing, and Urban Affairs committee. Since 1986, the NFIP has been self-sufficient and does not receive appropriations from general revenues to cover claims or administrative expenses, including salaries of 200 federal employees. However, the program itself must be reauthorized from time to time. It is currently authorized through FY 2008.

The NFIP's functions. The National Flood Insurance Program is meant to provide flood insurance to a wider range of property owners and in greater magnitudes than under free market conditions. In addition, the NFIP provides incentives for communities to adopt land use and construction rules that should reduce future flood losses. These risk measures are estimated to reduce flood losses by \$1 billion a year.

Program administration. The National Flood Insurance Program operates both directly and through private insurers to sell and service NFIP policies. In both cases, the NFIP assumes the insurance risk.

The NFIP Direct Program issues and administers policies directly through the NFIP. It represents less than 5% of policies in force as the NFIP has encouraged the private servicing of its policies for 20 years.

The Write Your Own Program allows insurers to handle flood insurance as consistently as possible with their other property lines. The company writes and services policies in its own name. The NFIP retains all financial risk and underwriting responsibilities while monitoring and regulating the WYO companies.

The NFIP retains all insurance risk. To offset this it receives premium payments, minus expense allowances (about one third of premium payments), from WYO companies. WYO companies also receive approximately 3.3% of the incurred loss when a claim is filed. More than 95 companies participate in this program and policies through the WYO program represent approximately 95% of total NFIP policies.

Insurance eligibility. In 1968, Congress designed the NFIP so that federal flood insurance is only available in communities that adopt and enforce local floodplain management ordinances. Communities are defined as political subdivisions which have land use authority, exercised

Insurance Levels

The NFIP insures losses up to these Congressionally-set ceilings:

Residential Buildings: \$250,000

Residential Contents: \$100,000

Condominium Buildings: \$250,000 per unit

Condominium Contents: \$100,000 per building

Rental Contents: \$100,000

Non-residential Buildings: \$500,000

Non-residential Contents: \$500,000

Coverage typically comes into effect 30 days after its purchase. Coverage above these limits may be available from some private insurers, but it is not protected by the NFIP.

Replacement. In cases where a home's value is less than 80% covered, the NFIP will pay the original cash value minus depreciation, as opposed to the full replacement cost that would be paid if it were more than 80% covered.

Premium costs. Premiums are set annually by the NFIP in order to adequately price risk and to keep the program from having to borrow to cover its expenses. In 1994, Congress established an annual limit on premium increases.

Service fees. A fee of \$30 is charged on each policy to cover the NFIP's administrative costs.

The premium for \$100,000 in coverage averages around \$400 per year, though actual rates vary with date of construction, physical location, deductibles, estimated replacement cost, and the flood mitigation efforts of the local community (CRS rating).

through planning and zoning ordinances and building codes. In exchange, homeowners, renters, and business owners in these communities are eligible to apply for federal flood insurance.

The early years of the NFIP revealed that many communities were slow to adopt floodplain management regulations and few property owners voluntarily purchased coverage. To address these issues, Congress instituted in 1972 what is known as the “mandatory purchase” requirements. Lenders that are federally regulated must force mortgage borrowers in mapped flood hazard areas to buy and retain flood insurance. This requirement was strengthened in 1994 by the imposition of penalties on lenders who do not comply. Federal agencies and government-sponsored enterprises also may not buy or insure mortgages that lack required flood insurance.

Qualified circumstances. For claims purposes, the NFIP defines a “general condition of flooding” as a partial or complete inundation of at least two acres or two properties situated on normally dry land. This may be caused by inland or tidal waters, runoff waters, mudflows, or land collapse caused by extraordinary tidal or river erosion. Most claims are paid within 30 to 60 days.

NFIP alternatives. Homeowners insurance typically does not cover floods. Homeowners or business owners can choose to acquire separate flood insurance from private insurers not affiliated with the NFIP, where available.

Consequences of no coverage. The President may make a major disaster declaration for a flooded area, enabling certain types of aid to be offered. In most instances, assistance for individuals will be in the form of small grants for emergency repairs, limited temporary housing, and SBA disaster assistance loans that must be repaid. Under certain circumstances, businesses may also qualify for SBA loans to help cover rebuilding costs associated with uninsured disaster losses. Of course, the original mortgage or lease on the property remains in place and must still be paid on the original terms. To qualify for these SBA disaster loans and FEMA assistance, the property owner must carry flood insurance going forward.

Finances

Overall size. The NFIP currently insures in excess of \$743.6 billion in assets. [See Table 1.](#) (Note that Table 1 relates to fiscal years and therefore excludes a substantial portion of the hurricane claims from 2004’s calendar year.) This covers more than 4.6 million policies for homes, businesses, and other non-residential property owners. Each year the NFIP collects premiums and fees, currently around \$2 billion per annum. The NFIP also pays out claims to

Table 1: Insured Policies

| Fiscal Years | 2002 Act. | 2003 Act. | 2004 Act. |
|---------------------------------------|--------------|--------------|--------------|
| Coverage | | | |
| Insured Coverage <i>in millions</i> | \$ 643,588 | \$ 681,048 | \$ 743,606 |
| Policies in force | 4,495,105 | 4,541,125 | 4,618,075 |
| Premiums | | | |
| Premiums Collected <i>in millions</i> | \$ 1,777 | \$ 1,869 | \$ 2,000 |
| Claims | | | |
| Claims Paid <i>in millions</i> | \$ 302 | \$ 838 | \$ 890 |
| Number of claims paid | 19,283 | 39,862 | 30,667 |

Source: FEMA Policy and Claim Statistics

policyholders. In fiscal 2004, it paid out \$890 million in claims to 30,667 policy holders. The most claims were paid out in fiscal 2001, when \$1.4 billion in claims were paid to 51,655 policyholders.

Statutory taxpayer exposure. By design, the NFIP sets premium rates to cover the average historical loss year; it does not attempt to build reserves sufficient to pay claims during very catastrophic loss years. In years when claims are larger than reserves, the NFIP has the authority to borrow from the Treasury. The NFIP may borrow up to \$3.5 billion from the Treasury, raised from \$1.5 billion as a result of Katrina. This borrowing authority is the entire statutory taxpayer exposure to this program. However, extreme losses, such as caused by Hurricane Katrina, could lead to a taxpayer rescue if legislators thought it prudent.

In general, funds borrowed from the Treasury are intended to be paid back with interest. Since 1990, NFIP has exercised its borrowing authority with the Treasury four times. In calendar year 2004, catastrophic losses from a destructive hurricane season caused more than 59,000 claims worth over \$1.6 billion. As a result, the NFIP borrowed \$200 million from the Treasury.

Losses from Hurricane Katrina were recently estimated by the Director of the Office of Management and Budget as being between \$10 and \$30 billion. These levels would require further borrowing authority for the NFIP, appropriations from Congress, or both.

NFIP budgeting. The NFIP is not funded by the taxpayers, except for borrowings described above and the likelihood of federal appropriations as a result of Katrina. Generally, it is fully funded through insurance premiums and fees paid by policyholders. [See Table 2.](#)

Table 2: Budget Costs

| Fiscal Years | NFIP | |
|---|-----------|-----------|
| | 2004 Act. | 2005 Est. |
| Costs in millions | | |
| Insurance Underwriting | \$ 580 | \$ 618 |
| Losses and Adjustments | \$ 1,485 | \$ 813 |
| Insurance and Mitigation Program | \$ 88 | \$ 93 |
| | \$ 2,153 | \$ 1,524 |
| Revenues in millions | | |
| Premiums, Fees, and Other Collections | \$ 1,892 | \$ 2,069 |
| Account Transfers (to Flood Mitigation) | \$ -20 | \$ -20 |
| Other | \$ 0 | \$ -6 |
| | \$ 1,872 | \$ 2,043 |
| Balance in millions | | |
| Balance from previous year | \$ 1,356 | \$ 1,078 |
| Total Costs | \$ -2,153 | \$ -1,524 |
| Total Revenues | \$ 1,872 | \$ 2,043 |
| Other funds available | \$ 3 | \$ 0 |
| Balance carried forward | \$ 1,078 | \$ 1,597 |

Source: President's FY2006 Budget Appendix

Current Issues

Hurricane Katrina. Massive flood claims due to Hurricane Katrina, estimated at between \$10 and \$30 billion, now dominate the agenda for debate regarding the NFIP. The program will need a huge increase in borrowing authority, appropriations from Congress, or both. If most of the funds are borrowed, there is the likelihood of later Congressional appropriations, since it seems unlikely that flood policyholders will be hit with a premium increase large enough to earn back losses that could run 15 times last year's premiums.

Proposed legislation. Prior to Katrina, proposed legislation in Congress concerning the NFIP centered on several issues. H.R. 804 and S. 1386 proposed to amend laws so that payments from the NFIP would not be considered income for tax and other purposes. H.R. 103 would provide flood insurance rate cuts to low income families on low cost properties in Special Flood Hazard Areas.

In addition, flood map modernization has been a chief concern of FEMA, as many flood maps have not been updated in over a decade. Flood mapping affects premiums, insurance availability, and mitigation efforts. As a result, Congress has appropriated funds for a multi-year modernization of FEMA flood hazard maps.

Sources

NFIP: Program descriptions via <http://www.fema.gov/nfip> and <http://www.floodsmart.gov>

U.S. Code: Full Text of 42 U.S.C. 50; available via <http://uscode.house.gov>

OMB: President's FY2006 Budget; available via <http://www.whitehouse.gov/omb>