Affordability of National Flood Insurance Program Premiums – Report 1
National Research Council

• National Academy of Sciences (NAS) operates under 1863 charter from U.S. Congress

• NAS established as honorary academy, and independent advisory body

• National Research Council (est. 1916) responds to requests from Congress, federal agencies, and others

• Nearly all NRC work conducted by committees of volunteer experts

• Not a governmental or policy making body. Serves in an advisory capacity
Project is congressionally mandated
Biggert-Waters 2012 Act – Section 100236

Statement of Task: Provide two reports to FEMA as part of its NFIP Affordability Study (also mandated in BW 2012)

First report:
• Discuss underlying definitions and concepts for affordability framework
• Methods for establishing affordability framework, including means-tested vouchers
• Appropriate and necessary assumptions, including “affordability” and “full risk-based premiums”

Second report:
• Propose alternative approaches for national evaluation of affordability program policy options
• Data issues including needs, availability, quantity, quality
• Appropriate methods and related considerations (e.g., models)
NRC Committee on Affordability of National Flood Insurance Program Premiums

Leonard Shabman, Chair, Resources for the Future, Washington, DC
Sudipto Banerjee, University of California, Los Angeles
John Boland, Johns Hopkins University, Baltimore, MD
Patrick Brockett, University of Texas, Austin
Raymond Burby, University of North Carolina, Chapel Hill
Scott Edelman, AECOM, Greensboro, NC
Michael Hanemann, Arizona State University, Tempe
Carolyn Kousky, Resources for the Future, Washington, DC
Howard Kunreuther, University of Pennsylvania, Philadelphia
Shirley Laska, University of New Orleans, LA
David Maidment, University of Texas, Austin
David Maurstad, OST, Inc., Washington, DC
Allen Schirm, Mathematica Policy Research, Washington, DC
Chapter 1 – Introduction

Chapters 2-5 – Background on NFIP history; insurance pricing principles, and NFIP premium pricing; factors that affect insurance purchase decisions; and places across the nation where effects of BW 2012 might be most pronounced.

Chapter 6 – Affordability concepts and framework for assistance program design

Chapter 7 – Policy alternatives to lower flood insurance costs for eligible households

Chapter 8 – Preview of Report 2
Topics and Objectives NOT addressed in Report 1:

• Does not design an affordability framework (rather, it advises FEMA, who must propose such a framework)

• Does not make recommendations on how to make flood insurance more affordable

• Does not offer a unique definition of what constitutes “affordability”

• Does not attempt to design new, or improve existing, national flood risk management programs.
“Affordable, Reasonable, and Fair”

Chapter 1 discussion –
Related to policy holders’ income or wealth

Terminology from 1950s and 1960s in original program discussions –
“reasonable” premiums.
This was to encourage purchase, and to consider existing properties constructed in higher-risk locations at a time when flood risk was less appreciated

Language from Homeowners Flood Insurance Affordability Act of 2014 asked NFIP to “strive for” premiums no greater than 1 percent of insurance policy coverage

“Affordable” is the phrase widely used today
NFIP History and Objectives (2)

Program created in 1968 as part of HUD; moved to FEMA in 1979

Original arrangement was partnership between fed gov’t-private insurance sector (with respective responsibilities and shared risks)

Initial efforts to keep claims reasonable
for pre-existing, or “pre-FIRM”, properties
by providing federal reinsurance for catastrophic loss events

1979 – Fed gov’t assumed full responsibility for NFIP

2005 – Katrina resulted in unprecedented claims and debt that exceeded NFIP ability to repay
NFIP Cumulative Debt
NFIP History (cont.)

Congress always has sought multiple objectives for the NFIP:
• Setting reasonable premiums
• Increasing awareness of flood risk by policy holders
• Promoting high take up rates, and community participation
• Collecting funds through premiums that would be adequate to cover claims and program expenses

These objectives are not always compatible, and at times may conflict with one another

BW 12 increased the emphasis on setting NFIP rates that reflected flood risk, and charging premiums to cover claims & expenses
Pricing, Policies, Premiums (3)

Presentation and discussion of actuarial principles in setting insurance policy premiums, and different NFIP policy types (pre-FIRM, grandfathered, etc.)

*Changes in policy pricing in BW 2012 and HFIAA:*
  BW 2012 sought to charge all properties NFIP risk-based rates (i.e., phasing out of pre-FIRM subsidies)

  HFIAA 2014 delayed, but did not reverse the BW 2012 requirement, to eliminate pre-FIRM subsidized rates. It also considers changes to risk-based rate setting practice.

  HFIAA 2014 reinstated the practice of “grandfathering.”
The Insurance Purchase Decision (4)

• Household decisions to purchase insurance can be evaluated through different models of choice. No single strategy will result in increased purchase of NFIP policies.

• Premium prices may affect take up rates; however, the strength of that effect is limited. The effect that available disaster aid has on that decision is uncertain. Lower premiums alone may not significantly increase take up rates.

• Studies show that individuals may employ intuitive thinking (vs. systematic consideration of cost vs. future claims) when choosing to forego insurance.
Locations of NFIP Affordability Challenges (5)

• About 60 percent of the approximately 5.5 million NFIP policies are in three states—Florida, Texas, and Louisiana.

• Available estimates suggest that in much of the nation take up rates are low, especially outside of Special Flood Hazard Areas (SFHAs).

• More than 1 million policy holders—or about 19 of the total—are paying pre-FIRM subsidized or grandfathered rates.
Locations of NFIP Affordability Challenges (5)

“Pre-FIRM subsidized” policies, by U.S. Census block groups
Affordability Concepts and Assistance Program Decisions (6)

- There are no objective definitions of affordability.
- The choice of definition can be informed by research and experience in administering means-tested programs.
- There are many ways to measure the cost burden of flood insurance on property owners, and renters.
Affordability Assistance Programs (6 and 7)

- FEMA and Congress will have to determine how to assess whether premiums are cost burdensome, and whether to provide financial assistance to targeted property owners and renters

  - Targeted assistance to cost burdened policy holders
    - Prioritizing existing mitigation grants
    - Providing loans based on targeting criteria
    - Providing vouchers based on targeting criteria
  - Across-the-board
    - Expanding the range of mitigation measures that can reduce premiums
    - Encouraging higher deductibles
    - Expanding the role of insurance agents in educating policy holders
    - Relying on federal Treasury to help pay claims in catastrophic loss years
Designing Targeted Assistance Programs for an Affordability Program

<table>
<thead>
<tr>
<th>Design Decisions</th>
<th>Policy Options</th>
</tr>
</thead>
</table>
| Who will receive assistance | • Cost burdened  
|                   | • Loss of pre-FIRM subsidy/grandfathering  
|                   | • Requirement to purchase flood insurance |
| What assistance will be provided | • Premium payment assistance  
|                   | • Mitigation cost assistance  
|                   | • Both |
| How will assistance be provided | • Vouchers  
|                   | • Mitigation loans and grants  
|                   | • Tax credits and deductions |
| How much assistance will be provided | • Formula for calculating amounts  
|                   | • Setting minimum and maximum amounts  
|                   | • Duration of assistance |
| Who will pay for assistance | • Allocate between taxpayers and policy holders who do not receive assistance |
| How will assistance be administered | • Specify the entities responsible for eligibility and assistance award determinations |
For free download of NRC committee’s report, please visit National Academies Press website at: www.nap.edu

For more information about this NRC project, please contact WSTB Director Jeff Jacobs at: jjacobs@nas.edu