Chapter 7 The National Flood Insurance Program

The National Flood Insurance Program aims to reduce the impact of flooding on private and public structures. It does so by providing affordable insurance to property owners, renters and businesses and by encouraging communities to adopt and enforce flood plan management regulations. These efforts help mitigate the effects of flooding on new and improved structures. Overall, the program reduces the socio-economic impact of disasters by promoting the purchase and retention of general risk insurance, but also of flood insurance, specifically.

The National Flood Insurance Act of 1968 created the National Flood Insurance Plan (NFIP) as an alternative to providing direct government assistance to homeowners after floods. The Act was passed in response to Congress finding that:

- Flooding disasters required unforeseen disaster relief and placed an increased burden on the nation's resources.
- The installation of flood preventive and protective measures and other public programs designed to reduce losses caused by flood damage had not been sufficient to adequately protect against the growing exposure to flood losses as a matter of national policy. A reasonable method of slowing the risk of flood losses would be through a program of flood insurance that could complement and encourage preventive and protective measures.
- Many factors made it uneconomical for private insurance industry carriers to make flood insurance available to those in need of such protection on reasonable terms and conditions.
- A program of flood insurance with large-scale participation of the Federal Government and the maximum extent practicable by the private industry was feasible and could be initiated.

Congress stated that its goals in creating the NFIP were to:

- Authorize a flood insurance program that, over time, could be made available across the country through the cooperative effort of the Federal Government and the private insurance industry;
- Provide flexibility in the program so that such flood insurance would be based on workable methods of pooling risks, minimizing costs, and distributing burdens equitably among the general public and those who would be protected by flood insurance; and
- Encourage state and local governments to use wisely the lands under their jurisdiction by considering the hazards of flood when rendering decisions on the future use of such land in order to minimize damage.

The Federal Emergency Management Agency (FEMA), part of the Department of Homeland Security, is responsible for the oversight and management of NFIP.

The Standard Flood Insurance Policy (SFIP) consists of three forms:

Dwelling Form:

The Dwelling Form is issued to homeowner, residential renter or owner of residential building containing one to four units. In NFIP Regular Program community or Emergency Program community, provides building and/or contents coverage for:

- Single-family, non-condominium residence with incidental occupancy limited to less than 50 percent of the total floor area;
- 2- to 4-family, non-condominium building with incidental occupancy limited to less than 25 percent of the total floor area;
- dwelling unit in residential condominium building;
- residential townhouse/row-house;
- personal contents in a non-residential building.

General Property Form:

The General Property Form is issued to owner of residential building with five or more units. In NFIP Regular Program community or Emergency Program community, provides building and/or contents coverage for these and similar "other residential" risks:

- apartment building;
- residential cooperative building;
- dormitory;
- assisted-living facility;
- hotels, motels, tourist homes, and rooming houses that have more than 4 units where the normal guest occupancy is six months or more.

The General Property Form can also be issued to the owner or lessee of non-residential building or unit. In an NFIP Regular Program community or Emergency Program community, this form provides building coverage and/or contents coverage for these and similar non-residential risks:

- hotel or motel with normal guest occupancy of less than 6 months;
- licensed bed-and-breakfast inn;
- retail shop, restaurant, or other business;
- mercantile building;
- grain bin, silo, or other farm building;
- agricultural or industrial processing facility;
- factory;
- warehouse;
- pool house, clubhouse, or other recreational building;
- house of worship;
- school;
- nursing home;
- non-residential condominium;
- condominium building with less than 75 percent of its total floor area in residential use;
- detached garage;
- tool shed;

- stock, inventory, or other commercial contents.

Residential Condominium Building Association Policy (RCBAP) Form:

Finally, the Residential Condominium Building Association Policy (RCBAP) is issued to residential condominium association on behalf of association and unit owners. In an NFIP Regular Program community only, it provides building coverage and, if desired, coverage of commonly owned contents for residential condominium building with 75 percent or more of its total floor area in residential use.

These three forms can be used as part of any of several specific "products" that are marketed by the NFIP under the broad category "Standard Flood Insurance Policy" or SFIP. These products include the following:

1. The Preferred Risk Policy (PRP) is available in moderate-risk flood zones.
2. Mortgage Portfolio Protection Program (MPPP) offers a force-placed policy available only through a Write Your Own (WYO) Company. See more details on this Program below.
3. The Scheduled Building Policy is available to cover 2 to 10 buildings. The policy requires a specific amount of insurance to be designated for each building. To qualify, all buildings must have the same ownership and the same location. The properties on which the buildings are located must be contiguous.
4. Group Flood Insurance is issued under the NFIP Direct Program in response to a Presidential disaster declaration. Disaster assistance applicants, in exchange for a modest premium, receive a minimum amount of building and/or contents coverage for a 3-year policy period. The Group Flood Insurance Policy cannot be canceled. However, an applicant may purchase a regular SFIP through the NFIP. When this is done, the group flood certificate for the property owner is void, and premium will not be refunded.

The NFIP is the only way that most homeowners can get flood insurance - and it's an important risk management tool for companies doing business in flood-prone areas. As of late 2010, the NFIP had more than 5.6 million policyholders insured for about $1.1 trillion; and the Plan collected about $2.9 billion in annual premiums.

Amount of Insurance Available under the NFIP:

Basic Insurance Limits Add'l Ins Total Ins
Emergency Regular Limits Limits
Building Coverage
Single-Family Dwelling $ 35,000 * $ 60,000 $190,000 $250,000
2-4 Family Dwelling $ 35,000 * $ 60,000 $190,000 $250,000
Other Residential $100,000 ** $175,000 $ 75,000 $250,000
Non-Residential $100,000 ** $175,000 $325,000 $500,000
Contents Coverage
Residential $ 10,000 $ 25,000 $ 75,000 $100,000
Non-Residential $100,000 $150,000 $350,000 $500,000
* In Alaska, Guam, Hawaii, and U.S. Virgin Islands, the amount available is $50,000.
** In Alaska, Guam, Hawaii, and U.S. Virgin Islands, the amount available is $150,000.

Note: For the RCBAP, refer to the Condominiums section of this manual for basic insurance limits and maximum amount of insurance available.
Since the NFIP's inception, Congress has enacted several pieces of legislation to strengthen or expand the program:

- The Flood Disaster Protection Act of 1973 made flood insurance mandatory for owners of properties in vulnerable areas who had mortgages from federally regulated lenders-and provided other incentives for communities to join the program.
- The National Flood Insurance Reform Act of 1994 strengthened the mandatory purchase requirements for owners of properties located in special flood hazard areas (SFHA) with mortgages from federally regulated lenders.
- The Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 authorized grant programs to mitigate properties that experienced repetitive flooding losses. Owners of these repetitive loss properties who do not mitigate face higher premiums.

One common theme to all of these refinements and reforms: Congress has consistently authorized the use of subsidized premiums to encourage homeowners and communities to join the NFIP. This means that the NFIP offers two types of flood insurance premiums: subsidized and full-risk. The subsidized premium rates, which usually represent about 35 to 40 percent of the cost of covering the full risk of flood damage to insured properties, accounted for about 23 percent of all NFIP policies as of the fall of 2010.

These subsidized premiums are controversial (as we will see in greater detail later). Critics say that they create market inefficiencies and distort some homeowners' notions of flood risks. For example: Approximately 36 percent of NFIP policies have the maximum coverage limits, with higher percentages in areas with higher median home values, such as coastal areas. But the percentage of policies sold at maximum coverage limits appears to be related not as much to flood losses in a particular state as it is to property values.

Case in point: the District of Columbia - which contains no coastal zone - has the highest percentage of maximum-coverage policies in the U.S.

And the most extreme effect: Property owners who are required to purchase an NFIP policy - but don't - may be automatically put in to "force-placed" insurance, primarily through private flood insurance but also through the NFIP's Mortgage Portfolio Protection Program. It is used only as a last resort and only on mortgages whose owners have failed to purchase flood insurance. According to one watchdog agency:

NFIP's rate-setting process for full-risk premiums may not ensure that those premium rates reflect the actual risk of flooding and therefore may increase NFIP's financial risk. Moreover, FEMA's rate-setting process for subsidized properties depends, in part, on the accuracy of the full-risk rates, raising concerns about how subsidized rates are calculated as well.
FEMA and the NFIP have traditionally identified flood hazard areas on maps that are provided to communities for carrying out their responsibilities. These maps assign flood zone designations based on local geography, flooding histories and risk levels. And these designations are a major factor in determining premium rates for flood insurance. (We will also examine NFIP rating

formulas in greater detail later.)

However, flaws and inefficiencies in the maps and NFIP rating formulas have lead to consistent financial losses and troubles for the Plan. In the late 2000s, both the U.S. Senate and House of Representatives introduced legislation aimed at "reforming" the NFIP. While these bills differed in several particulars, they agreed about the need to improve the viability of the Plan after it had to borrow billions of dollars from the Treasury Department to pay for catastrophic losses following the 2005 hurricane season.

Total NFIP flood losses in 2005, including Hurricanes Katrina and Rita, were about $17.6 billion. In response to the magnitude and severity of the losses from the 2005 hurricanes, Congress increased NFIP's borrowing authority from the Treasury Department to $20.775 billion. And the program ended up using most of that "line of credit."

According to FEMA, despite the general economic downturn, 2010 was a good year for the NFIP. Policy sales and retention both improved; also, collected premiums rose 24 percent over the three years leading up to June 2010. This increase, combined with a relatively low loss experience over the same period, enabled the NFIP to make nearly $600 million in payments to the Treasury Department.

Still, in the opinion of the GAO and other organizations familiar with the NFIP's finances, the Plan is unlikely to pay off the $18.8 billion debt it had with the Treasury Department in 2010.

Waiting Periods:

Most NFIP policies require some type of waiting period before taking effect-these requirements are designed to prevent insureds from buying coverage in the hours before a major storm or flood event has been predicted to occur.
With a few exceptions, the effective date of a new NFIP policy will be 12:01 a.m., local time, on the 30th calendar day after the presentment of premium.
The three main exceptions to this 30-day waiting period are:

1. There is no waiting period if the initial purchase of flood insurance on an Application requiring the Submit-for-Rate procedure is in connection with making, increasing, extending, or renewing a loan, provided that the policy is applied for and the presentment of premium is made at or prior to the loan closing. The rules provided in subsection A. Receipt Date must be used unless the premium payment was made from the escrow account (lender's check), title company, or settlement attorney. If a loss occurs during the first 30 days of the policy period, the insurer must obtain documentation, such as settlement papers, to verify the effective date of the policy before adjusting the loss.

2. The 30-day waiting period does not apply when flood insurance is required as a result of a lender determining that a loan that does not have flood insurance coverage should be protected by flood insurance, because the building securing a loan is located in an SFHA. The coverage is effective upon the completion of an Application and the presentment of premium. This exemption from the 30-day waiting period applies only to loans in SFHAs,

i.e., those loans for which the statute requires flood insurance. The rules provided in subsection A. Receipt Date must be used. If a loss occurs during the first 30 days of the policy period, the insurer must obtain documentation, such as a copy of the letter requiring mandatory purchase, to verify the effective date of the policy before adjusting the loss.

3. During the 13-month period beginning on the effective date of a map revision, the effective date of a new policy shall be 12:01 a.m., local time, following the day after the date the increased amount of coverage is applied for and the presentment of additional premium is made. This rule applies only on an initial purchase of flood insurance where the FHBM or FIRM is revised to show the building to be in an SFHA when it had not been in an SFHA. The rules provided in subsection A. Receipt Date must be used. If a loss occurs during the first 30 days of the policy period, the insurer must obtain documentation, such as a copy of the previous and current map or other documentation confirming the map revision or update, to verify the effective date of the policy before adjusting the loss.

One more exception: The 30-day waiting period does not apply when an insured decides to rewrite the existing policy at the time of renewal from a standard-rated policy to a PRP, provided that the selected PRP coverage:

limit amount is no higher than the next-highest PRP amount above that which was carried on the standard-rated policy using the highest of building and contents coverage. If the standard-rated policy has only contents coverage and is rewritten as a contents-only PRP, the 30-day waiting period does not apply.

When converting a standard-rated policy to a PRP, the 30-day waiting period will not apply if the standard-rated policy has only building coverage and is rewritten as a PRP that includes contents coverage.

In addition, if the structure is no longer eligible under the PRP or the insured decides to rewrite the existing PRP at renewal time to a standard-rated policy, the 30-day waiting period does not apply provided the coverage limit amount is no more than the previous PRP coverage amount or the next-higher PRP amount above that.
Also, the 30-day waiting period does not apply when the additional amount of flood insurance is required in connection with the making, increasing, extending, or renewing of a loan, such as a second mortgage, home equity loan, or refinancing. The increased amount of flood coverage shall be effective at the time of loan closing, provided that the increased amount of coverage is applied for at or before closing. The rules provided in subsection A. Receipt Date must be used.
And certain increases in coverage requested while an NFIP policy is in place make take effect immediately or after a one-day waiting period.
Finally, in some cases, the insured can purchase an endorsement which reduces the waiting period from 30 days to one day.

NFIP Eligibility Rules

Here are the basic eligibility rules for NFIP flood insurance:

- Flood insurance may be written only in those communities that have been designated as participating in the National Flood Insurance Program (NFIP) by the Federal Emergency Management Agency (FEMA).
- The Emergency Program is the initial phase of a community's participation in the NFIP. Limited amounts of coverage are available.
- The Regular Program is the final phase of a community's participation in the NFIP. In this phase, a Flood Insurance Rate Map is in effect and full limits of coverage are available.
- Maps of participating communities indicate the degree of flood hazard so that actuarial premium rates can be assigned for insurance coverage on properties at risk. These maps include:

1. Flood Hazard Boundary Map (FHBM) - Usually the initial map of a community. Some communities entering the Regular Program will continue to use an FHBM renamed a Flood Insurance Rate Map if there is a minimum flood hazard.
2. Flood Insurance Rate Map (FIRM) - The official map of the community containing detailed actuarial risk premium zones.

- Probation, imposed by the FEMA Regional Director, occurs as a result of noncompliance with NFIP floodplain management criteria. A community is placed on probation for one year (may be extended), during which time a $50 surcharge is applied to all NFIP policies, including the Preferred Risk Policy (PRP), issued on or after the Probation Surcharge effective date. Probation is terminated if deficiencies are corrected. However, if a community does not take remedial or corrective measures while on probation, it can be suspended.
- Flood insurance may not be sold or renewed in communities that are suspended from the NFIP. When a community is suspended, coverage remains in effect until expiration. These policies cannot be renewed.
- When FEMA provides a non-participating community with an FHBM or a FIRM delineating its flood prone areas, the community is allowed one year in which to join the NFIP. If the community chooses not to participate in the NFIP, flood insurance is not available.
- Flood insurance may not be available for buildings and/or contents located in coastal barriers or otherwise protected areas. These areas are listed in a separate Coastal Barrier Resources System.

To participate in NFIP, local communities (counties, cities, towns, etc.) agree to enforce regulations for land use and new construction in high-risk flood zones - and to adopt and enforce state and community floodplain management regulations to reduce future flood damage.
In 2010, more than 20,000 communities participated in NFIP.
In return for this community participation, FEMA makes flood insurance coverage available on buildings and their contents throughout the community.
NFIP coverage is available to all owners of insurable property (a building or its contents - or both) in a community participating in NFIP. Builders of buildings in the course of construction, condominium associations and owners of residential condominium units in participating communities may also purchase flood insurance.
Specifically, NFIP coverage can be written on any of the following types of property:
Eligible Buildings. Insurance may be written only on a structure with two or more outside rigid walls and a fully secured roof that is affixed to a permanent site. Buildings must resist flotation, collapse, and lateral movement. At least 51 percent of the Actual Cash Value (ACV) of buildings,

including machinery and equipment, which are a part of the buildings, must be above ground level, unless the lowest level is at or above the Base Flood Elevation (BFE) and is below ground by reason of earth having been used as insulation material in conjunction with energy-efficient building techniques.
Appurtenant Structures. The only appurtenant structure covered by the SFIP is a detached garage at the described location, which is covered under the Dwelling Form. Coverage is limited to no more than 10 percent of the limit of liability on the dwelling. Use of this insurance is at the policyholder's option but reduces the building limit of liability. Appurtenant structure coverage does not apply to any detached garage used or held for use for residential (dwelling), business, or farming purposes.
Manufactured (Mobile) Homes/Travel Trailers. A manufactured home (a "manufactured home," also known as a mobile home, is a structure built on a permanent chassis, transported to its site in one or more sections, and affixed to a permanent foundation); and a travel trailer without wheels, built on a chassis and affixed to a permanent foundation, that is regulated under the community's floodplain management and building ordinances or laws. To be insurable under the NFIP, a mobile home must be:

- affixed to a permanent foundation: a permanent foundation for a manufactured (mobile) home may be poured masonry slab or foundation walls, or may be piers or block supports, either of which support the mobile home so that no weight is supported by the wheels and axles of the mobile home.
- anchored, if located in a Special Flood Hazard Area (SFHA): a manufactured or mobile home located within an SFHA must be anchored to a permanent foundation to resist flotation, collapse, or lateral movement by providing over-the-top or frame ties to ground anchors; or in accordance with manufacturer's specifications; or in compliance with the community's floodplain management requirements.

(All manufactured or mobile homes on a foundation continuously insured since September 30, 1982, can be renewed under the previously existing requirements if affixed to a permanent foundation.
Silos and Grain Storage Buildings
Cisterns
Buildings Entirely Over Water - Constructed or Substantially Improved before October 1, 1982. Pre-FIRM buildings constructed before October 1, 1982, are eligible for normal Pre-FIRM rates. If the building was constructed or substantially improved on or after October 1, 1982, the building is ineligible for coverage. Exception: If a building was originally constructed on land or partially over water, and later becomes entirely over water because of erosion, it is eligible for coverage only if the building has had continuous coverage:

- from the period beginning at least one year prior to the building being located entirely over water, regardless of any changes in the ownership of the building; or
- from the date of construction if less than one year.

Buildings Partially Over Water
Boathouses Located Partially Over Water. The non-boathouse parts of a building into which

boats are floated are eligible for coverage if the building is partly over land and also used for residential, commercial, or municipal purposes and is eligible for flood coverage. The area above the boathouse used for purposes unrelated to the boathouse use (e.g., residential occupancy) is insurable from the floor joists to the roof, including walls. A common wall between the boathouse area and the other part of the building is insurable. The following items are not covered:

- The ceiling and roof over the boathouse portions of the building into which boats are floated;
- Floors, walkways, decking, etc., within the boathouse area, or outside the area, but pertaining to boathouse use;
- Exterior walls and doors of the boathouse area not common to the rest of the building;
- Interior walls and coverings within the boathouse area; and
- Contents located within the boathouse area, including furnishings and equipment, relating to the operation and storage of boats and other boathouse uses.

Buildings in the Course of Construction. NFIP rules allow for the issuance of an SFIP to cover a building in the course of construction before it is walled and roofed. These rules provide lenders with an option to require flood insurance coverage at the time that the development loan is made to comply with the mandatory purchase requirement outlined in the Flood Disaster Protection Act of 1973, as amended. The policy is issued and rated based on the construction designs and intended use of the building. Buildings in the course of construction that have yet to be walled and roofed are eligible for coverage except when construction has been halted for more than 90 days and/or if the lowest floor used for rating purposes is below the BFE. Materials or supplies intended for use in such construction, alteration, or repair are not insurable unless they are contained within an enclosed building on the premises or adjacent to the premises.
Severe Repetitive Loss Properties: These must be processed by the NFIP Special Direct Facility.
Single Building. To qualify as a single-building structure and be subject to the single-building limits of coverage, a building must be:

1. Separated from other buildings by intervening clear space; or
2. Separated into divisions by solid, vertical, load-bearing walls; each division may be insured as a separate building.
    - These walls must divide the building from its lowest level to its highest ceiling and have no openings.
    - If there is access through the division wall by a doorway or other opening, the structure must be insured as 1 building unless it meets all of the following criteria:
        - It is a separately titled building contiguous to the ground; and
        - It has a separate legal description; and
        - It is regarded as a separate property for other real estate purposes, meaning that it has most of its own utilities and may be deeded, conveyed, and taxed separately.

Additions and Extensions. The NFIP insures additions and extensions attached to and in contact with the building by means of a rigid exterior wall, a solid load-bearing interior wall, a stairway, an elevated walkway, or a roof. At the insured's option, additions and extensions connected by any of

these methods may be separately insured. Additions and extensions attached to and in contact with the building by means of a common interior wall that is not a solid load-bearing wall are always considered part of the building and cannot be separately insured.
Eligible Contents. Contents must be located in a fully enclosed building. However, under the Dwelling Form, in a building that is not fully enclosed, contents must be secured to prevent flotation out of the building.
Vehicles and Equipment. The NFIP covers self-propelled vehicles or machines, provided they are not licensed for use on public roads and are:

1. Used mainly to service the described location; or
2. Designed and used to assist handicapped persons while the vehicles or machines are inside a building at the described location.

Silos, Grain Storage Buildings, and Cisterns. Contents located in silos, grain storage buildings, and cisterns are insurable.
Commercial Contents in a residential property must be insured on the General Property Form.
Some specific examples of *ineligible* risks:

- Bailee's Customer Goods - including garment contractors, cleaners, shoe repair shops, processors of goods belonging to others, and similar risks
- Boat Repair Dock
- Boat Storage Over Water
- Camper
- Contents Located in a Building Not Fully Walled and/or Contents Not Secured Against Flotation
- Contents Located in a Structure Not Eligible for Building Coverage
- Cooperative Unit within Cooperative Building
- Decks (except for steps and landing; maximum landing area of 16 sq. Ft.)
- Drive-In Bank Teller Unit (located outside walls of building)
- Fuel Pump
- Gazebo (unless it qualifies as a building)
- Greenhouse (unless it has at least 2 rigid walls and a roof)
- Hot Tub or Spa (unless it is installed as a bathroom fixture)
- Motorized Equipment - Including dealer's stock (assembled or not)
- Non-Residential Condominium Unit
- Open Stadium
- Pavilion (unless it qualifies as a building)
- Pole Barn (unless it qualifies as a building)
- Pumping Station (unless it qualifies as a building)
- Storage Tank - Gasoline, water, chemicals, sugar, etc.
- Swimming Pool (indoor or outdoor)
- Swimming Pool Bubble
- Tennis Bubble
- Tent

- Timeshare Unit within Multi-Unit Building
- Travel Trailer (unless converted to a permanent on-site building meeting the community's floodplain management permit requirements)
- Water Treatment Plant (unless at least 51% of its ACV is above ground)

The owner of a non-residential condominium unit cannot purchase building coverage. Contents-only coverage may be purchased by the unit owner.

How the NFIP responds to catastrophes

FEMA and various Coastal Plans will determine whether a catastrophe event will necessitate a Single Adjuster Program (SAP) response. The National Weather Service declaration of a tropical storm or hurricane event will begin the watch for possible single adjuster response. When the storm is 48 hours from landfall, this will initiate FEMA's approval of the SAP response.

During that time, the NFIP Bureau and Statistical Agent's General Adjusters will be deployed to strategic areas close to where the storm is predicted to strike. At landfall, they will be able to immediately assess the damage impact from the storm. No later than 24 hours after landfall, the WYO Companies will be advised by telephone, fax, or email through their designated Single Adjuster Liaison, as to the areas and state(s) that will be activated. At that point, the WYO Companies will be asked to immediately notify their agents/producers of the SAP procedures in reporting the claims.

The NFIP Bureau will notify the WYO Companies by telephone, fax, or email to have their agency staff submit all flood losses that are reasonably believed to involve wind and flood damage to the State Coastal Plans (i.e., Windpool, Fairplan, Beachplan, etc.).

The NFIP will notify all SAP Liaisons of the CCO's location, telephone number, fax number, and address, if the CCO does not co-locate with the State Coastal Plans.

When the CCO is operational, the WYO Companies will be notified of all assigned claims. Notice of losses reflecting the assigned adjusting firms will be faxed each day. Once the assignment is made and communicated to each company, the WYO Company will manage its own loss adjustment. However, the Catastrophe CCO will ensure that the adjuster receives a copy of the loss assignments, the name of the WYO Company, and the SAP Liaison telephone number.

Risk and NFIP

The NFIP is not an actuarially sound insurance program - Under its authorizing legislation, NFIP must offer subsidized flood insurance premiums along with its full-risk premiums. As we've noted, the subsidized premiums (which fund only about 35 to 40 percent of the cost of covering the actual risk of flood damage to the insured properties) account for almost one out of every four active residential NFIP policies.

Making matters even more difficult: the NFIP's full-risk rates are often based on outdated information and processes, so even these rates may not reflect the actual risk of flood-related loss.

So, the NFIP does not operate like most private insurance companies. From an actuarial standpoint, the biggest differences between it and conventional insurers are that the NFIP is:

1. not structured to build a capital surplus,
2. likely unable to purchase reinsurance to cover catastrophic losses,

3. unable to reject high-risk applicants, and
4. subject to statutory limits on rate increases.

That last point bears repeating: Many NFIP-insured property owners pay premium rates that do not reflect the full, long-term risk of flooding - and the law limits the NFIP's ability to correct the inefficiencies.

So, the NFIP allows some insured property owners to continue to pay rates that Plan underwriters and administrators know do not reflect reassessments of their properties' flood risk. And these aren't even what the NFIP means when it uses the term "subsidized rates," although - strictly speaking - they could be called that. (To avoid confusion, the NFIP refers to these rates as "grandfathered rates.")

FEMA documents state that properties are grandfathered in order to recognize policyholders who have complied with their original FIRM, have remained loyal NFIP customers, or both. In general, two categories of buildings may be grandfathered into the program

1. those built in compliance with the FIRM that was in effect at the time of construction and
2. those built before a FIRM was in effect or that were not in compliance at the time of construction.

For those buildings in compliance at the time of construction, property owners need to provide documentation of the date of the original FIRM and the property's flood zone, base flood elevation (BFE) and other map-related information. Properties that were not in compliance generally can be grandfathered if they have had continuous flood insurance and if the building has not been altered in certain ways.

While FEMA does not consider the premiums on these properties to be subsidized because they are based on the average risk for the whole class to which they had been assigned previously, they share two characteristics with subsidized rates:

1. rates based on new FIRMs should more accurately reflect flood risk, but grandfathered properties will not be charged those rates; and
2. the grandfathered status of a property continues indefinitely, even when the property is sold.

In most property and casualty insurance lines, state assessments are often passed through to policyholders. As a result, policyholders living in less risky locations also contribute to cover the shortfall - a scenario known as cross-subsidization.

In those states where assessments cannot be passed through in some manner, private insurers must pay the assessments while at the same time paying large claims from their own policyholders. In such instances, some companies may be reluctant to continue offering coverage in the state or may become insolvent.

FEMA officials acknowledged that property owners that obtain grandfathered rates for their homes are being cross-subsidized by other policyholders in the same zone that are paying higher rates. For example, under grandfathering, repetitive loss properties remapped into a higher-risk zone instead would pay a rate generally charged to lower-risk properties.

These are pre-FIRM properties that were built before detailed flood hazard data and flood elevations were provided to the community and usually before the community enacted comprehensive regulations on floodplain regulation.

The officials also stated that in making this decision they took into consideration several concerns:

1. potentially higher rates that could cause property owners not to buy insurance or to lose their properties,
2. adverse reactions to FEMA as the result of these higher rates,
3. the burden on insurance agents of obtaining new map determinations and information for every policyholder, and

4. the likelihood of communities resisting new maps due to the potential for large rate increase

While grandfathered rates are used to keep existing policyholders, FEMA has not taken steps to measure the impact of these rates on the program's financial condition. FEMA officials said that they currently had limited data on new or existing grandfathered properties and are just beginning to explore ways to track these properties. For example, they had not tracked the number of grandfathered properties or calculated how much lower grandfathered premiums are than the actual rates.

As a result, they did not know the effect of grandfathered properties on the program's total premium collection and the extent to which these rates deviate from fully risk-based rates. Without this information, FEMA's ability to address the financial impact of such properties on NFIP's financial health is limited.

Why can't the NFIP charge premiums high enough to build a capital surplus for years when there are unusual or catastrophic losses? Because the program was enacted to encourage property owners in vulnerable areas to join the program and maximize the number of participants. Its "primary public policy goal" is to provide flood insurance in flood-prone areas to property owners who otherwise would not be able to obtain it.

In other words, it's designed to lose money.

Which leads to its second big problem: Unlike private insurance companies, NFIP assumes all the risk for the policies it sells.

Private insurers typically retain only part of the risk that they accept from policyholders, ceding a portion of the risk to reinsurers(insurance for insurers). This mechanism is particularly important in the case of insurance for catastrophic events, because the availability of reinsurance allows an insurer to limit the possibility that it will experience losses beyond its ability to pay.

NFIP's lack of reinsurance, combined with the lack of structure to build a capital surplus, transfers much of the financial risk of catastrophic floods to the Treasury Department and - ultimately - to the American taxpayer.

A separate - but simultaneous - problem: The NFIP is required to accept virtually all applications for insurance, unlike private insurers, which can reject applicants for a variety of reasons. Because it can't deny insurance on the basis of frequent losses, the NFIP is less able to offset the effects of adverse selection; that is the phenomenon in which those people or entities most likely to purchase insurance are also the most likely to experience losses.

Adverse selection usually leads to market inefficiencies: such as concentrations of policyholders in the riskiest areas.

This problem is further compounded by the fact that those at greatest risk are required to purchase insurance from NFIP if they have a mortgage from a federally regulated lender.

Finally, by law, the Plan is prevented from raising rates on each flood zone by more than 10 percent each year. While most states regulate premium prices for private insurance companies on other lines of insurance, they generally do not set limits on premium rate increases, instead focusing on whether the resulting premium rates are justified by the projected losses and expenses.

These rates allow policyholders with structures that were built before floodplain management regulations were established in their communities to pay premiums that represent about 35 to 40 percent of the actual risk premium.

"Repetitive Loss" Properties

In reauthorizing NFIP in 2004, Congress noted that repetitive loss properties - those that have had two or more flood insurance claims payments of $1,000 or more over 10 years - constituted a significant drain on NFIP resources.

According to the NFIP's own numbers, repetitive loss properties represent only about one percent of its total number of policies - but account for 25 to 30 percent of claims.

That bears repeating: approximately one percent of NFIP policies account for between 25 and 30 percent of its claims expenses.

Various individuals and organizations have made suggestions for how the NFIP might limit its exposure to repetitive-loss property claims. For example, the Government Accountability Office (GAO) has suggested that "one option for Congress would be to substantially expand mitigation efforts and target these efforts toward the highest-risk properties."

FEMA and the NFIP have experimented with a variety of mitigation efforts for high-risk properties - including elevation, relocation and demolition. As of 2010, the NFIP had five different mitigation grant programs, each with different types of requirements, purposes and appropriations:

1. Flood Mitigation Assistance (FMA),
2. Repetitive Flood Claims (RFC),
3. Severe Repetitive Loss Pilot Program (SRL),
4. Hazard Mitigation Grant Program (HMGP), and
5. Pre-Disaster Mitigation (PDM).

Despite these efforts, the inventories of repetitive loss properties and policies with subsidized premium rates have continued to grow.

Mitigation requirements criteria could be made more stringent-for example:

- requiring all insured properties that have filed two or more flood claims (even for small amounts) to mitigate,
- denying insurance to property owners who refuse or do not respond to a mitigation offer, or
- some combination of these approaches.

While these actions would help reduce losses from flood damage and could ultimately limit costs to taxpayers by decreasing the number of subsidized properties, they would require increased funding for FEMA's mitigation programs, to elevate, relocate, or demolish the properties, would be costly to taxpayers, and could take years to com Probability of elevation plete.

Congress could also consider changes to address loopholes in mitigation and repurchase requirements that allow policyholders to avoid mitigating by simply not responding to FEMA's requests that they do so. FEMA could be required to either drop coverage for such properties or use eminent domain to seize them if owners fail to respond to FEMA's mitigation requests. Moreover, Congress could streamline the various mitigation grant programs to make them more efficient and effective.

Not all repetitive loss properties are part of the subsidized property inventory, but a high proportion receives subsidized rates, further contributing to NFIP's financial risks. While Congress has made efforts to target these properties, the number of repetitive loss properties has continued to grow, making them an ongoing challenge to NFIP's financial stability.

The NFIP'S Financial Issues

The number of policies receiving subsidized rates has grown steadily in recent years and without changes to the program will likely continue to grow, increasing the potential for future NFIP operating deficits.

FEMA estimates that properties covered by policies with subsidized rates experience as much as five times more flood damage than compliant new structures that are charged full-risk rates.

The result is predictable: As of October 2008, NFIP owed interest payments of $730 million a year to Treasury and had to borrow more from the Treasury to make these payments.

The program, "as currently designed," is not likely to generate sufficient revenue to repay this debt.

As of June 2008, NFIP's average non-catastrophic historical loss year (which excludes Hurricanes Katrina, Rita, and Wilma) is about $1.3 billion. The combined outlays for loss and loss adjustment expenses of around $1.3 billion, administrative expenses of approximately $1 billion, and interest payments of approximately $0.7 billion exceed the program's current premium collection of approximately $2.6 billion. Under current conditions, it is unlikely that NFIP will be able to meet its interest payments in most years, and the program's debt will likely grow as the program borrows to meet the interest payments.

Because of the NFIP's financial situation, the GAO has placed the program on its high-risk list - which means it's likely to cost taxpayers significantly more than its current financial reports indicate. The GAO considered the NFIP's over financial health and prospects in a 2009 report (the full text is available here:). And it didn't like what it found:

[The NFIP] likely will not generate sufficient revenues to repay the billions of dollars borrowed from the Treasury Department to cover claims from the 2005 hurricanes or future catastrophic losses.

The lack of sufficient revenues highlights structural weaknesses in how the program is funded.

Also, weaknesses in NFIP management and operations, including financial reporting processes and internal controls, and oversight of contractors place the program at risk.

The potential losses generated by NFIP create substantial financial exposure for the federal government and U.S. taxpayers. While Congress and FEMA intended that NFIP be funded with premiums collected from policyholders rather than with tax dollars, the program is, by design, not actuarially sound.

NFIP's financial condition improved slightly during the late 2000s, due to an increase in the number of policyholders and moderate flood losses. And, especially in 2009, FEMA took some steps toward improving the NFIP's financial position - including paying down its debt to Treasury by almost $850 million. However, the program was supposed to repay some $18.5 billion owed to the Treasury Department by the end of 2010. That didn't happen.

NFIP and private flood insurance

Of course, the government isn't the only place to go for flood insurance. Some private-sector insurance companies offer coverage. But the NFIP's subsidized rates have marginalized these carriers and set the tone for the overall flood insurance marketplace.

The private-sector market for residential flood insurance is small and focuses on homes with values over $1 million. The private commercial market is also relatively small, focusing on larger companies that use NFIP coverage to finance the deductibles on private policies.

A 2007 Rand Corp. study commissioned by FEMA estimated that between 180,000 to 260,000 private-sector insurance policies for both primary and excess coverage were in effect. Four large insurance companies provided almost all of this private flood insurance:

1. American International Group,

2.Chubb,
3.Fireman's Fund, and
4.Lloyds of London.

(Although AIG has effectively ceased to exist after its highly-publicized financial problems in 2008, its share of the private-sector flood insurance market has been maintained by successor companies.)

Private-sector flood insurance can be significantly more expensive than NFIP insurance for similar levels of coverage. So, most often, private flood insurance policies are purchased in conjunction with NFIP policies - with the NFIP policy paying an amount equal to the deductible on the private policy.

According to anecdotal evidence gathered by the GAO and other organizations that have analyzed the NFIP's operations and finances:

•the cost for a specified level of residential coverage could be as low as $500 from NFIP and as high as $900 from a private insurer;
•for contents insurance, the cost averages around $350 from NFIP but around $600 in the private market;
•large companies are the primary purchasers of private commercial flood insurance, and "several insurers and industry officials" say that private flood insurance for small to medium-sized businesses is prohibitively expensive;
•up to 80 percent of private policies provide excess coverage above the NFIP maximum and are purchased together with NFIP policies, and the remaining 20 percent is considered "first dollar" coverage;
•generally, the NFIP policy covers the deductible on the private policy - commercial policies often set the deductible at NFIP policy limits;
•private-sector insurers also generally determine their premium rates using NFIP rates, data and flood maps as a starting point - and adjust rates (usually upward) according to their own risk analyses.

Some private-sector insurers will write residential flood coverage on a primary basis, but it is much more expensive than excess insurance because primary coverage exposes the insurer to the first loss position and most flood-related losses are less than the NFIP coverage limits. This means that excess coverage is tapped only for losses above the NFIP coverage limit.

On the commercial lines side, private insurance can be purchased alone or included as part of a multi-peril property-casualty policy. While little aggregate data is available, most industry officials agree that private flood insurance for small and medium-size businesses is prohibitively expensive in most situations.

One type of flood insurance that private-sector carriers do offer - and that the NFIP, at least currently, does not - is business interruption coverage for commercial insureds. This coverage is expensive and, generally, only large companies can afford it.

Private-sector business interruption coverage for flood losses is usually available only if the purchaser also has a property-casualty policy that includes flood coverage. So, the insureds are already paying a lot for top-of-the-line coverage.

Underwriting flood-related business interruption coverage is complex; properly pricing the risks requires an extensive evaluation of a company's business model and cash flow - to determine the kinds of losses that a business interruption might involve.

Adjusting business interruption claims is also complex and often contentious, because the extent of a loss depends on the nature of the business and the circumstances surrounding the triggering flood event.

Some experts have suggested that an NFIP-subsidized business-interruption policy could be a way for smaller businesses to obtain such coverage; but adding business interruption coverage would further strain the NFIP's human and financial resources. (And sophisticated insureds would likely use NFIP business interruption coverage to cover deductibles on private policies, as they do with property coverage.)

More importantly: Because business interruption insurance is so complex to underwrite - and unless it were sold at a price adequate to cover the expected losses - it could increase the federal government's exposure to catastrophic flood losses.

Flooding happens every day in regions all across our country. A flood can happen even in areas that might not seem at risk. Floods do not always result from hurricanes; they can happen due to extreme conditions, such as rain, rapid spring melts, or high river conditions. It is not necessary to live in a coastal area to experience a flood. In 2004, Pennsylvania, which has no ocean coastline, received more than $175 million in flood insurance payments – second only to Florida. [3] Every property owner should consider the threat of floods when insuring their homes and businesses.

The floods we tend to read about follow such events as hurricanes or nor'easters, but more floods happen every day resulting from small, localized events. Everyone must realize that it only takes a few inches of water in a home to cause thousands of dollars in damage. In fact, flooding in the United States is the number one natural hazard.

Homeowner's insurance will not cover flooding; it is necessary to protect their home and property by purchasing a flood insurance policy separately through their local insurance agent. As long as the individual's hometown is an NFIP community, most people, including those who rent, can get flood insurance. The National Flood Insurance Program wants consumers to understand the flood insurance basics, including:

You can get flood insurance nationwide.

- •You can get flood insurance if you live in a floodplain or high-flood-risk area.
- •You can get flood insurance if you live outside a floodplain, or low to moderate flood risk area (and at a lower cost).
- •You can get flood insurance if your property has experienced a past flood.
- •You can get flood insurance from agents in your area.
- •You can buy flood insurance even if your mortgage broker does not require such coverage.

What does this mean? It means that just about everyone should consider purchasing flood insurance. Over 25 percent of the NFIP claims were paid in low-to-moderate flood risk areas, such as zones B, C or X.

Mandatory Purchase of Flood Insurance in High Flood Risk Zones

The Flood Disaster Protection Act of 1973 placed the requirement on federally regulated lending institutions to ensure that loans secured by buildings located in high flood risk areas are protected by flood insurance. Lenders call these areas the Special Flood Hazard Areas (SFHA). They are Zone A and V. The National Flood Insurance Reform Act of 1994 further strengthened the requirements. Agents may view the Mandatory Purchase of Flood Insurance Guideline booklet online at http://www.fema.gov/nfip/mpurfi.shtm. The booklet is a guide for lending institutions, but it can help the flood insurance agent too. Agents provide important information to lenders concerning their flood insurance needs that may go beyond meeting the minimal mandatory requirements established by law.

Recommended in Moderate and Low Flood Risk Zones

Individuals may go online to determine their personal flood risk. Floodsmart.gov provides this information to anyone wishing to access it online. By entering property information, they will show the relative flood risk, links to flood insurance resources, and a list of licensed insurance agents serving the area. As we have previously stated, flood insurance is recommended even in low to moderate flood risk zones.

Why Flood Insurance is Better Than Disaster Assistance

The President must declare a major disaster before most forms of federal assistance is available. The most common form of federal disaster assistance is a Small Business Administration (SBA) low-interest disaster assistance loan, which must be repaid with interest. The average federal Individuals and Households Program (IHU) award is around $4,000. To qualify for federal Home Repair Assistance the individual's home must have eligible relatively minor damage that can be quickly repaired. Individuals cannot qualify for federal Rental Assistance unless their home has been heavily damaged or destroyed.

Disaster assistance loans from SBA are usually more costly than flood insurance premiums, so it makes sense to purchase flood policies.

Flood Loss Avoidance

What is a flood loss avoidance?

Flood loss avoidance is a protective action policyholders take to minimize flood damage and losses to their buildings and personal property before a flood occurs.

What's covered under a Standard Flood Insurance Policy?

National Flood Insurance Program flood policies will cover up to $1,000 in reasonable expenses incurred to protect policyholders' insured property, and up to $1,000 to move their insured property away from a flood or imminent danger of a flood. To be eligible for this benefit, the insured property must be located in a community where:

- A general condition of flooding in the area exists; or
- An official has issued an evacuation order or other civil order for the community requiring measures to preserve life and property from flooding.

What is eligible?

Expenses to protect your property:

- Sandbags (including the sand to fill them)
- Fill to create temporary levees
- Water pumps
- Plastic sheeting and lumber used in connection with any of these items listed above
- Labor – a policyholder may claim labor, including their own or a family member's labor, at the federal minimum wage. Labor charged by a professional may also be reimbursed.

Expenses to move your property to safety:

- Up to $1,000 for the reasonable expense to move their insured property in order to protect it rom flood, or the imminent danger of flood.

What do you need to know?

- Personal property that is moved must be placed in a fully enclosed building or otherwise protected from the elements.
- Any property removed, including a moveable home (that meets the definition of a building in the flood policy), must be placed above ground level or outside of the special flooding hazard area.
- Property removed is covered by your flood policy for 45 consecutive days from the date the move begins.
- A deductible does not apply to these limits.
- The coverage does not increase the policy limits of the liability.

Paid Receipts:

Policyholders should keep copies of all receipts and a record of the time spent performing the work.

They should be submitted to their insurance adjuster when they file a claim to be reimbursed.