

Chapter 5 FEMA Law

In designing NFIP, Congress required that premiums for certain properties be offered at prices below those for full-risk premiums to encourage participation in the program and to ensure that premiums were affordable for existing structures in the floodplain. However, the statute does not provide a formula or methodology for setting the subsidies, leaving it up to the program to develop one.

When the program began, NFIP administrators set the subsidized rates on the basis of what they believed would be affordable, but this process resulted in losses that had to be covered by borrowings as discussed previously. Some of the resulting deficit was later forgiven by Congress.

In 1981, NFIP administrators, after discussions with congress, started setting NFIP's subsidized premium rates based on the average historical loss year calculations.

According to FEMA, this change allowed the agency to resist external pressures in setting premium rates and provided a more objective standard for determining subsidized rates. FEMA documents from most years between 2001 and 2006 state that the average historical loss year target, which is based on losses from previous years averaged over time, generally is considered a floor for premium collection.

To account for the potential of catastrophic losses, and the additional funds required to pay such losses, FEMA sets premium rates so that the total premiums collected will be approximately 15 to 25 percent greater than the average historical loss year estimate.

However, FEMA can adjust - and has recently adjusted - the way it calculates the average historical loss year.

According to FEMA officials, including the 2005 losses in calculations of the average historical loss year would have resulted in premium increases well above the 10 percent statutory limit. As a result, FEMA officials instituted a weighting factor for the 2005 losses, and as a result the full amount of the losses was not incorporated into the rate-setting model. According to FEMA officials, they incorporated losses of \$2.1 billion of the estimated \$23.2 billion in losses from 2005.

In its review of the NFIP's operations, the GAO noted:

FEMA raised rates by an average of more than 9 percent on about one percent of all NFIP policies - specifically, on certain subsidized policies located in high-risk coastal zones. In contrast, FEMA raised rates by an average of around two percent on 40 percent of total policies in high-risk zones that were paying full-risk rates. Ultimately, the generally small increases will not help ensure NFIP's financial stability and may in fact decrease it by adding to its operating deficit.

The processes and policies that FEMA uses to set both full-risk and subsidized premium rates have contributed to NFIP's inability to generate enough in premiums to cover the program's operating costs, claims losses, and debt to the Treasury.

From 1978 through 2004, NFIP had a net loss of \$2 billion. These years had historically low flooding, but NFIP had yearly deficits for about half of these years. Over that period, Congress retired about \$1.2 billion of this total debt. However, the introduction of average historical loss