GAO Highlights

Highlights of GAO-14-127, a report to congressional committees

January 2014

FLOOD INSURANCE

Strategies for Increasing Private Sector Involvement

Why GAO Did This Study

NFIP has accrued $24 billion in debt, highlighting structural weaknesses in the program and increasing concerns about its burden on taxpayers. As a result, some have suggested shifting exposure to the private sector and eliminating subsidized premium rates, so individual property owners—not taxpayers—would pay for their risk of flood loss. NFIP was created, in part, because private insurers were unwilling to insure against flood damage, but new technologies and a better understanding of flood risks may have increased their willingness to offer flood coverage.

The Biggert-Waters Flood Insurance Reform Act of 2012 moves NFIP toward charging more full-risk rates. It also mandates that GAO conduct a study on increasing private sector involvement in flood insurance. This report addresses (1) the conditions needed for private sector involvement in flood insurance and (2) strategies for increasing private sector involvement. To do this work, GAO reviewed available documentation and hosted a roundtable in August 2013 that included stakeholders from FEMA, the insurance and reinsurance industries, and state insurance regulators, among others. GAO also interviewed other similar stakeholders.

What GAO Recommends

While GAO makes no new recommendations in this report, GAO reiterates its previous suggestion from a June 2011 report (GAO-11-297) that Congress consider eliminating subsidized rates, charge full-risk rates to all policyholders, and appropriate funds for premium assistance to eligible policyholders to address affordability issues.

View GAO-14-127. For more information, contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov.

What GAO Found

According to stakeholders with whom GAO spoke, several conditions must be present to increase private sector involvement in the sale of flood insurance. First, insurers need to be able to accurately assess risk to determine premium rates. For example, stakeholders told GAO that access to National Flood Insurance Program (NFIP) policy and claims data and upcoming improvements in private sector computer modeling could enable them to better assess risk. Second, insurers need to be able to charge premium rates that reflect the full estimated risk of potential flood losses while still allowing the companies to make a profit, as well as be able to decide which applicants they will insure. However, stakeholders said that such rates might seem unaffordable to many homeowners. Third, insurers need sufficient consumer participation to properly manage and diversify their risk, but stakeholders said that many property owners do not buy flood insurance because they may have an inaccurate perception of their risk of flooding.

Stakeholders identified several strategies that could help create conditions that would promote the sale of flood insurance by the private sector. For example,

- *NFIP charging full-risk rates*. Congress could eliminate subsidized rates, charge all policyholders full-risk rates, and appropriate funding for a direct means-based subsidy to some policyholders. Stakeholders said full-risk NFIP rates would encourage private sector participation because they would be much closer to the rates private insurers would need to charge. The explicit subsidy would address affordability concerns, increase transparency, and reduce taxpayer costs depending on the extent and amount of the subsidy. The Biggert-Waters Act eliminates some subsidized rates, but some have proposed delaying these rate increases. Doing so could address affordability concerns, but would also delay addressing NFIP's burden on taxpayers.
- *NFIP providing residual insurance*. The federal government could also encourage private sector involvement by providing coverage for the highest-risk properties that the private sector is unwilling to insure. Providing residual coverage could increase the program's exposure relative to the number of properties it insured, but NFIP would be insuring fewer properties, and charging adequate rates could reduce taxpayer costs.
- *NFIP as reinsurer*. Alternatively, the federal government could serve as a reinsurer, charging a premium for assuming the risk of catastrophic losses. However, the cost of reinsurance premiums would likely be passed on to consumers, with higher rates potentially decreasing consumer participation.

Stakeholders identified other strategies including mandatory coverage requirements to ensure broad participation, NFIP purchasing reinsurance from the private sector rather than borrowing from the U.S. Treasury, and NFIP issuing catastrophe bonds to transfer risk to private investors. As the private sector increases its role in providing flood coverage, the federal government could collaborate with state and local governments to focus on other important roles, including promoting risk awareness among consumers, encouraging mitigation, enforcing building codes, overseeing land use agreements, and streamlining insurance regulations.