# The National Flood Insurance Program (NFIP)

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# National Flood Insurance Program[1]

*Overview*

Congress enacted the National Flood Insurance Act in 1968 creating the National Flood Insurance Program (NFIP) in response to the rising cost of taxpayer-funded disaster relief for flood victims and the increasing amount of damage caused by floods. Before passage of the Act, the national response to flood disasters had been to build dams, levees and other structures to hold back flood waters, a policy that may have encouraged building in flood zones. The NFIP combines the concepts of insurance protection and hazard mitigation by making federally-backed flood insurance available for residential and commercial properties in communities that agree to adopt and enforce floodplain management ordinances to reduce future flood damage.

Nearly 20,000 communities across the U.S. and its territories participate in the NFIP by adopting and enforcing floodplain management ordinances to reduce future flood damage. In exchange, the NFIP makes federally-backed flood insurance available to homeowners, renters, and business owners in these communities. As a priority, the 1968 Act required that flood insurance be made available to 1-4 family residential buildings, small businesses, and churches. Flood insurance has since been made available to other residential properties, other business properties, agricultural properties, properties occupied by private nonprofit organizations and properties owned by state or local governments. Insurance is available for all these types of properties and their contents with limited exceptions.

Flood insurance covers direct physical losses by flood and losses resulting from flood-related erosion caused by waves or currents of water exceeding anticipated cyclical levels and accompanying a severe storm, flash flood, abnormal tide surge or a similar situation which results in flooding. Mudflows (which occur when water rapidly accumulates in the ground, such as during heavy rainfall or rapid snowmelt) are covered under the NFIP. However, landslides are not. In addition to providing flood insurance

[1] This chapter is part of a larger Insurance Information Institute (III) report titled "Public/Private Mechanisms For Handling Catastrophic Risks in the United States." The full report can be found at: http://www.iiidaily.com/iiidisasterpaper.pdf

and reducing flood damages through floodplain management regulations, the NFIP identifies and maps the nation's floodplains. Mapping flood hazards creates broad-based awareness of the flood hazards and provides the data needed for floodplain management programs and to actuarially rate new construction for flood insurance.

From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance in the U.S. was entirely voluntary. The 1973 Act added mandatory purchase requirements for properties in flood prone areas where the purchaser sought either a mortgage from a federally regulated lending institution or federal assistance. This meant that flood insurance coverage became mandatory for many properties in flood prone areas not previously covered under the voluntary program. Flood damage is excluded under typical homeowners' policies, but coverage is provided under the comprehensive section of standard auto policies and some coverage is also available under special commercial insurance policies.

In 2004, President Bush signed into law the Flood Insurance Reform Act, reauthorizing the NFIP through 2008. The NFIP is managed by the Mitigation Division within the Federal Emergency Management Agency (FEMA). FEMA is part of the Department of Homeland Security's Emergency Preparedness and Response Directorate.

*How the NFIP Operates*

A community establishes its eligibility to participate in the NFIP in two ways:

- By adopting and enforcing floodplain management measures to regulate new construction, and
- By ensuring that substantial improvements to existing buildings within identified Special Flood Hazard Areas (SFHAs) are designed to eliminate or minimize future flood damage.

An SFHA is an area within a floodplain having a 1 percent or greater chance of flood occurrence in any given year. SFHAs are delineated on flood maps issued by the Federal Emergency Management Agency (FEMA) for individual communities. These flood zones are represented on the flood maps by darkly shaded areas with zone designations that include the letter A or V.

Property owners in NFIP communities may purchase flood insurance whether the building or its contents is located in or outside the floodplain. In fact, one in four NFIP claims comes from outside high-flood-risk areas. In order to be eligible for flood insurance, a structure must have at least two solid walls and a roof, be principally above ground, and not entirely over water. Community participation in the NFIP is voluntary.

Federal flood coverage initially was available only via insurance agents who dealt directly with the Federal Insurance Administration (FIA). In 1979, the FIA was placed under the Federal Emergency Management Agency (FEMA), and since 1983 the "direct" policy program has been supplemented with a program known as the Write-Your-Own (WYO) Program.

The WYO program allows a pool of participating property/casualty insurance companies to write and service the Standard Flood Insurance Policy in their own names. The premium charged by the private insurer is the same as that charged by the federal government through the direct program. Nearly all of the flood policies issued today are written through WYO policies.

The WYO program was started to increase the NFIP policy count and geographic distribution of policies by taking advantage of the private insurance industry's marketing channels and existing policy base to sell flood insurance. NFIP policies in force doubled from around two million in 1985 to 4.4 million by 2000, and rose to 4.7 million in 2004 *(Exhibit 1)*. At the same time, the total value of property insured under the NFIP is growing rapidly and rose to $764.5 billion in 2004 *(Exhibits 2 and 3)*. Some 20,000 communities are participants in the NFIP, while 93 insurance companies were writing flood insurance for the NFIP, 95 percent of those through the WYO Program.

A private insurer becomes a WYO company by entering into a contract, known as the Financial Assistance/Subsidy Arrangement, with the FIA. Under the arrangement, private insurers agree to issue flood policies in their own name. In addition, the WYO companies adjust flood claims as well as settle, pay and defend all claims arising from the flood policies. The companies receive an expense allowance for policies written and claims processed, while the federal government retains responsibility for underwriting losses.

Maximum amounts of coverage are available under the NFIP via two programs: the emergency program and the regular program. The emergency program is the initial phase of a community's participation in the NFIP. Only limited amounts of coverage are available under this program. 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.

Nearly all participating communities are in the regular program, and individuals can purchase flood insurance up to the following amounts:

- Residential 1-4 family unit buildings and individual residential condominium units are written under the dwelling form and are eligible for up to $250,000 in building coverage and up to $100,000 in personal property coverage.
- Residential buildings containing more than four units are eligible for up to $250,000 in building coverage and up to $100,000 on personal property.
- Non-residential buildings are eligible for up to $500,000 in building coverage and up to $500,000 on personal property written on the general property form.
- Under the Residential Condominium Building Association Policy (RCBAP) form, a condominium association can purchase coverage on a building, which includes all the units within the building and the improvements within the units, up to $250,000 times the number of units within the residential building. Personal property coverage on the form is limited to $100,000 per building.

NFIP coverage for the structure and contents of the home are sold separately. Buildings and structures are covered for replacement cost value, but contents coverage is available on an actual cash value basis only. There may also be limits on coverage for furniture and other possessions stored in basements. Coverage is also limited within the Coastal Barrier Resources System (CBRS). Congress passed laws limiting Federal expenditures in certain coastal areas and designating them as a part of the CBRS or as Otherwise Protected Areas (OPAs). In these areas, there is a prohibition for the expenditure of most Federal funds. These prohibitions refer to "any form of loan, grant, guarantee, insurance, payment, rebate, subsidy or any other form of direct or indirect Federal assistance," with specific and limited exceptions.

There is a 30-day waiting period before coverage takes effect under the NFIP. However, there is no waiting period if the initial purchase of flood insurance is in connection with the making, increasing, extending or renewing of a loan. Also, if the initial purchase of flood insurance is made during the 13-month period following the effective date of a revised flood map for a community, there is a one-day waiting period.

NFIP premiums grew from $1.9 billion in 2003 to $2.1 billion in 2004 *(Exhibit 4)*. The NFIP notes that floods can occur anywhere, including outside of high-flood-risk zones, such as on mountains and in deserts. Most single-family homes, town homes, and apartments in these areas are eligible for the NFIP's preferred risk policy (PRP), a lower cost flood insurance policy. The premium for this policy can be as little as $112 a year for $20,000 of building coverage and $8,000 in contents coverage. According to a study being conducted for the NFIP by the Rand Corporation, nationwide about 49 percent of single-family homes in special flood hazard areas (SFHAs) are covered by flood insurance. In the South, the percentage is higher – about 61 percent. However, outside of the high risk areas there is a steep drop off in coverage. Only about one percent of homeowners in non-SFHAs purchase it.

*Claims-Paying Capacity*

Funding for the NFIP is via the National Flood Insurance Fund, which was established in the Treasury by the 1968 Act. The NFIP is self-supporting for the average historical loss year. This means that losses and operating and administrative expenses are not paid for by the taxpayer, but through premiums collected for flood insurance policies and deposited into the fund. In addition, the Program has the authority to borrow up to $1.5 billion from the Treasury when losses are heavy, although these loans must be repaid along with interest.

Until 1986, Federal salaries and program expenses, as well as the costs associated with flood hazard mapping and floodplain management were paid by an annual appropriation from Congress. From 1987 to 1990, Congress required the Program to pay these expenses out of premium dollars. In current dollars $485 million of policyholder premiums were transferred to pay salary and other Program expenses. From 1991, a Federal policy fee of $25, increased to $30 in 1995, is applied to most policies in order to generate the funds for salaries, expenses, and mitigation costs.

*How the Claims System Works*

As in other types of insurance, claims under the NFIP require that the insured file a proof of loss. A proof of loss -- the policyholder's valuation of claimed damages – is a sworn statement made by the policyholder that substantiates the insurance claim. This must be submitted within 60 days of the loss, unless waived by the administrator of the Federal Insurance and Mitigation Administration (FIMA). Claims can be adjusted using either an independent adjuster or an adjuster employed by a WYO company.

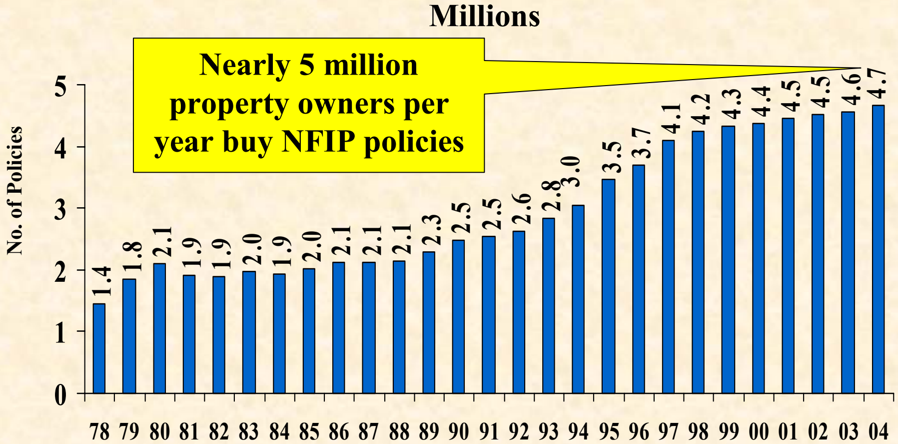
Under all NFIP policies, the insured pays a portion of the loss through the application of a deductible. A minimum deductible is applied separately to a building and its contents, although both may be damaged in the same flood. Higher deductibles are available, and an insurance agent can provide information on specific amounts of available deductibles. Optional high deductibles reduce policy premiums but will have to be approved by the mortgage lender.

NFIP claims are growing. In 2004, the NFIP paid some 37,659 claims, up from 36,271 claims paid in 2003 *(Exhibit 5)*. This compared with 25,220 in 2002 and 43,503 in 2001, the year of Tropical Storm Allison. Flood losses paid totaled $1.2 billion in 2004, up from $759.8 million in 2003 *(Exhibit 6)*. The average cost of a flood claim in 2004 was $32,056, and the average flood insurance premium was $438 *(Exhibit 7)*. The NFIP has received significant claims from Hurricane Katrina, the Category 4 storm that struck the states of Louisiana, Mississippi and Alabama in late August 2005.

An insured will never be paid more than the value of the covered loss, less deductible, up to the amounts of insurance purchased. Therefore, purchasing flood insurance to value is an important consideration. The amount of insurance a property owner needs should be discussed with an insurance agent or broker.

Exhibit 1

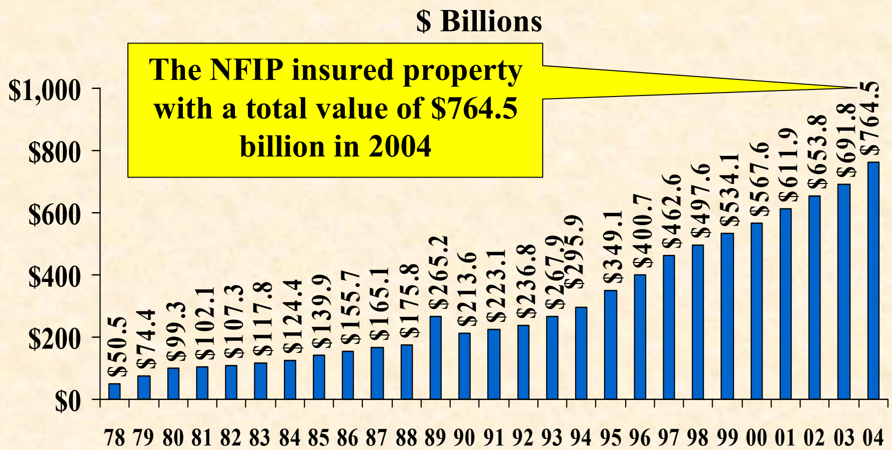
# NFIP: Total Policies in Force by Calendar Year 1978-2004




Source: FEMA, National Flood Insurance Program (NFIP)

Exhibit 2

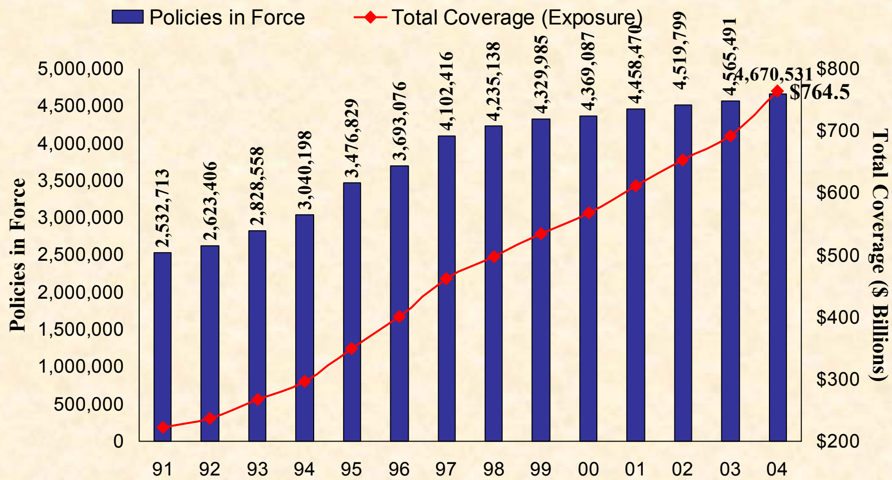
# NFIP: Total Coverage by Calendar Year 1978-2004




Source: FEMA, National Flood Insurance Program (NFIP)

Exhibit 3

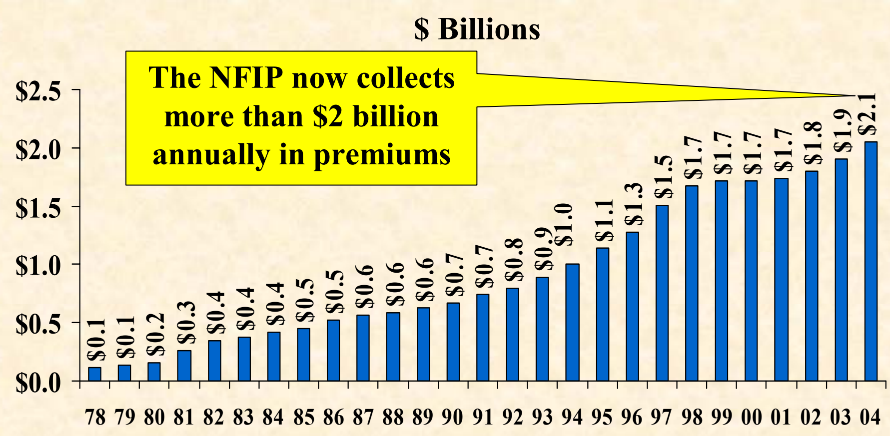
# NFIP: Policies in Force and Total Coverage (Exposure)




Sources: FEMA, National Flood Insurance Program (NFIP)

Exhibit 4

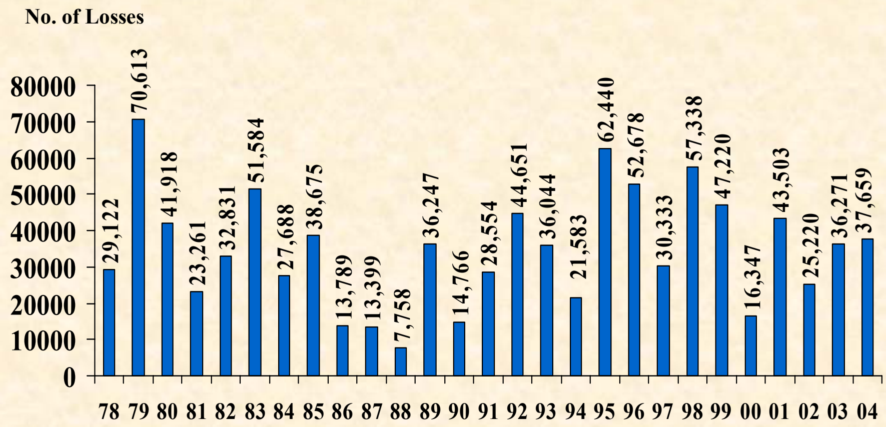
# NFIP: Total Premium by Calendar Year 1978-2004




Source: FEMA, National Flood Insurance Program (NFIP)

Exhibit 5

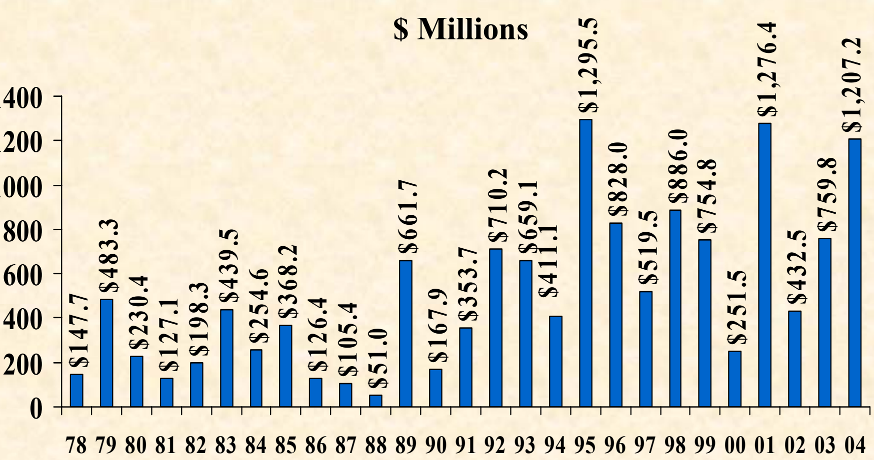
# *NFIP: No. of Losses Paid by Calendar Year 1978-2004*




Source: FEMA, National Flood Insurance Program (NFIP)

Exhibit 6

# *NFIP: Loss Dollars Paid by Calendar Year 1978-2004*




Source: FEMA, National Flood Insurance Program (NFIP)

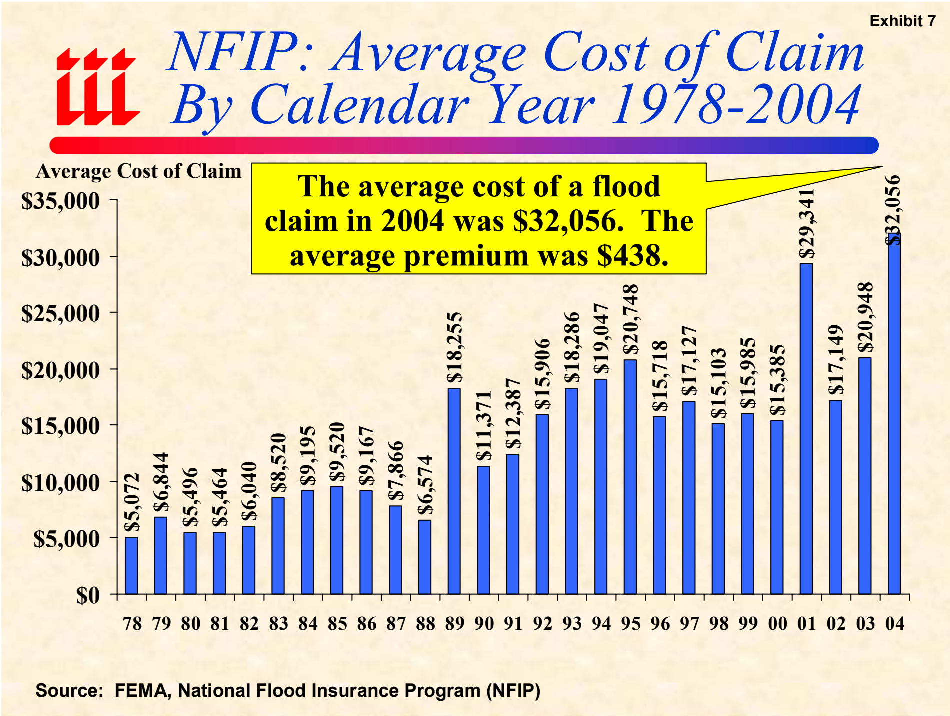


Exhibit 7
NFIP: Average Cost of Claim
By Calendar Year 1978-2004
Average Cost of Claim
The average cost of a flood claim in 2004 was $32,056. The average premium was $438.
$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$0
$5,072
$6,844
$5,496
$5,464
$6,040
$8,520
$9,195
$9,520
$9,167
$7,866
$6,574
$18,255
$11,371
$12,387
$15,906
$18,286
$19,047
$20,748
$15,718
$17,127
$15,103
$15,985
$15,385
$29,341
$17,149
$20,948
$32,056
78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04
Source: FEMA, National Flood Insurance Program (NFIP)