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Private Flood Insurance and the National Flood Insurance Program (NFIP)

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The National Flood Insurance Program

The NFIP was first authorized by the National Flood Insurance Act of 1968 (42 U.S.C. §4001 *et seq.*), and was reauthorized until the end of FY2017 by the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12, Title II of P.L. 112-141). After a series of short-term reauthorizations, S. 3628 in the 115th Congress reauthorized the NFIP until May 31, 2019. In statute, Congress has found that

> (1) many factors have made it uneconomic for the private insurance industry alone to make flood insurance available to those in need of such protection on reasonable terms and conditions; but
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> (2) a program of flood insurance with large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated. (42 U.S.C. §4001(b)).

By law or regulation, federal agencies, federally regulated lending institutions, and government-sponsored enterprises (GSEs) must require certain property owners to purchase flood insurance as a condition of any mortgage that these entities make, guarantee, or purchase. Property owners are required to purchase flood insurance if their property is identified as being in a Special Flood Hazard Area (SFHA, which is equivalent to having a *1% or greater* risk of flooding every year) and is in a community that participates in the NFIP. Historically, this has generally meant that such property owners were required to purchase a Standard Flood Insurance Policy (SFIP) from the NFIP. In BW-12, Congress explicitly provided for private flood insurance to fulfill this mortgage requirement instead of the SFIP, *if* the private flood insurance met the conditions defined further in statute at 42 U.S.C. §4012a(b)(7).

Rulemaking on Accepting Private Flood Insurance

To fulfill the mortgage requirement, a private insurance policy must provide, among other conditions, "flood insurance coverage which is at least as broad as the coverage provided under a [SFIP] … including when considering deductibles, exclusions, and conditions offered by the insurer." The implementation of this requirement has proved challenging, with the responsible federal regulators (the Federal Reserve, Farm Credit Administration, Federal Deposit Insurance Corporation, National Credit Union Administration, and Comptroller of the Currency) issuing two separate Notices of Proposed Rulemaking (NPRM) addressing the issue in October 2013 and November 2016. The crux of the implementation issue can be seen as answering the question of who would judge whether specific policies met the "at least as broad as" standard and what criteria would be used in making this judgment? The uncertainty as to whether particular private policies would meet the standard has been seen as "at odds with" greater private participation in the flood insurance marketplace.

On February 12, 2019, the regulators announced a final rule implementing the BW-12 "requirement that regulated lending institutions accept private flood insurance policies." Of particular note, the rule

- "allows institutions to rely on an insurer's written assurances in a private flood insurance policy stating the criteria are met; [and]
- clarifies that institutions may, under certain conditions, accept private flood insurance policies that do not meet the Biggert-Waters Act criteria."

The rule takes effect on July 1, 2019. Press reports described it as generally welcomed by the banking industry. It does not apply directly to other federal agencies, nor to the GSEs, which would be subject to separate rulemaking.

Congressional Legislation

To date, no legislation has been introduced directly addressing private flood insurance in the 116th Congress. In past Congresses, two bills have passed the House on the issue: H.R. 2874 in the 115th Congress and H.R. 2901 in the 114th Congress. Although these bills were similar, H.R. 2874 was a broader bill that would have included a longer-term reauthorization and other changes. Both bills would have revised the definition of *private flood insurance* previously defined in BW-12. The definition proposed would have required federal agencies to accept private flood insurance from both admitted and nonadmitted (i.e., surplus lines) insurers as long as the private insurance coverage "complies with the laws and regulations of that State." In revising the definition, both H.R. 2901 and H.R. 2874 would also have removed existing statutory language describing how private flood insurance must provide coverage "as broad as" that provided by the SFIP and clarified that if a property owner purchases private flood insurance and decides then to return to the NFIP, they would be considered to have maintained *continuous coverage*. Continuous coverage is required for property owners to retain any subsidies or cross-subsidies in their NFIP premium rates. A borrower may be reluctant to purchase private insurance if doing so means they would lose their subsidy should they later decide to return to NFIP coverage.

Options for Privatizing Flood Insurance

Section 100232(a) of BW-12 required both FEMA and the GAO to produce separate studies that "assess a broad range of options, methods, and strategies for privatizing the [NFIP]." In the GAO study on privatization, the GAO reviewed a wide range of strategies to encourage private flood insurance. The strategies included eliminating subsidies of NFIP premium rates entirely, or providing the subsidies in an explicit form not hidden in the premium; shifting the federal role to reinsuring primary flood insurance instead of directly providing it; mandating flood coverage in homeowners insurance policies; and authorizing the NFIP to issue catastrophe bonds to transfer some of the insured risk.

The required FEMA study on privatization discussed several key challenges that may be presented by privatizing a larger segment of NFIP policy base, including how to

- maintain the funding of federal flood mapping and flood mitigation programs largely paid for through SFIP premiums;
- reduce and pay off the billions of dollars of debt NFIP owes to the U.S. Treasury; and
- ensure the affordability and continued availability of flood insurance to property owners in flood zones.

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For further discussion of the possible role of private insurance in the NFIP, see CRS Report R45242, *Private Flood Insurance and the National Flood Insurance Program*, by Diane P. Horn and Baird Webel.

Author Information

Baird Webel
Specialist in Financial Economics

Diane P. Horn
Analyst in Flood Insurance and Emergency Management

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