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S. 1940 – Flood Insurance Reform and Modernization Act

Noteworthy

- **Floor Situation:** On Thursday, June 21, the Senate may vote on the motion to proceed to the Flood Insurance and Modernization Act (S. 1940), also known as the Flood Insurance bill. Senator Reid filed cloture on the motion to proceed to the Flood Insurance bill on Wednesday, June 20, 2012. Senators Shelby and Johnson of South Dakota have filed a substitute amendment to S. 1940, the committee-reported bill. This Legislative Notice is based on the language in the substitute amendment.

- **Background:** S.1940 was introduced by Senator Tim Johnson on December 5, 2011, and was unanimously reported out of the Senate Committee on Banking, Housing, and Urban Affairs the same day.

- **Executive Summary:** The substitute amendment reauthorizes the National Flood Insurance Program (NFIP) through September 30, 2017. The NFIP is set to expire on July 31, 2012, unless Congress reauthorizes it. A lapse in the program is expected to affect the housing market because: 1) it affects the soundness of collateral backing to the banking industry's loan portfolios; 2) homebuyers in flood hazard areas need to purchase flood insurance as a condition of obtaining mortgage financing; and 3) it ensures that claims are paid to more the 5.6 million existing NFIP policy holders.

Background

The National Flood Insurance Program was created in 1968 to address the nation's flood exposure and alleviate taxpayers' responsibility for flood losses because, as has proven to be the case, managing flood risk was too great for the private sector to cover.

The Flood Disaster Protection Act of 1973 established a mandatory flood insurance purchase requirement for structures located in identified Special Flood Hazard Areas (SFHA), also known as the 100-year flood plain. Under the 1973 act, federally regulated lenders were obligated to require flood insurance on any mortgage issued or guaranteed by the federal government in a designated SFHA in a participating community.

Today, eligible homeowners, renters, and business owners purchase coverage under the program either directly from the NFIP or from private insurers that voluntarily participate in the Write Your Own (WYO) program. WYO insurers take responsibility for policy administration and claims processing but assume no financial risk in settling claims. As of 2010, there are approximately 5.6 million residential and commercial policyholders under the NFIP.

The NFIP is administered by the Federal Emergency Management Agency. The NFIP generated premium income of approximately $3.3 billion in 2010. The 2005 hurricane season resulted in significant claims which the program's annual premium income could not cover. To pay the claims, the NFIP borrowed from the U.S. Treasury. Prior to 2005, the NFIP's borrowing authority had been limited by statute to $1.5 billion. Congress made up for the shortfall by increasing the program's borrowing authority three times between September 2005 and January 2007 (from $1.5 billion to $20.8 billion). The NFIP currently owes $17.775 billion to the U.S. Treasury. Since 2006, the Government Accountability Office has identified the NFIP as ‘‘high-risk’’ because of inadequate management and insufficient funds.

Overview

- Requires FEMA to review flood insurance rates and use actuarial principles in setting those rates.

- Increases flood insurance premiums for pre-FIRM (Flood Insurance Rate Maps) properties that are: non-residential or non-primary residences; residences sold to new owners; or severe repetitive loss properties.

- Requires flood coverage for property owners in "residual risk areas" (behind levees, downstream from dams, etc.) to reflect actual risk of flooding.

- Sets minimum deductibles for pre-FIRM property deductibles at $1,500 if the property is insured for $100,000 or less, or $2,000 if the property has over $100,000 in coverage. Post-FIRM minimum property deductibles are at $1,000 for those with $100,000 of coverage or less, or $1,250 if the coverage is greater than $100,000. FEMA currently has the discretion to set a minimum deductible.

- Requires the GAO to conduct a study on the possibility of including optional business interruption and/or additional living expenses coverage, and the effects that these optional coverage options could have on the NFIP.

- Requires FEMA to submit a report to Congress on the capacity of the private reinsurance, capital, and financial markets to assume a portion of the NFIP's insurance risk.

House Action

On July 12, 2011, the House passed a bill addressing flood insurance, the Flood Insurance Reform Act of 2011, H.R. 1309, 406 to 22.

Bill Provisions

This Legislative Notice is based on the language in the Shelby/Johnson (SD) substitute amendment.

Title I – Flood Insurance Reform and Modernization

This title allows multifamily residential buildings (more than four families) to purchase flood insurance up to the limits for business properties.

This title reforms the premium rate structure to require increases in flood insurance premiums for pre-FIRM properties that are: non-residential or non-primary residences; residences sold to new owners; or severe repetitive loss properties. One year after enactment, all policyholders of properties in these categories will have premium increases of 15 percent per year until the amount collected each year covers the actuarial cost of the insurance. New policies that fit such criteria one year after enactment would immediately be required to pay the full-risk premium. The current cap on annual increases is 10 percent.

This title requires that lending institutions escrow flood insurance payments for properties that are located in mandatory purchase areas. It also requires FEMA to allow policyholders that are not required to have their premiums escrowed every month with their lender to pay their premiums in installments. FEMA currently requires a single annual premium payment.

This title requires the GAO to conduct a study on the possibility of including optional business interruption and/or additional living expenses coverage, and the effects that these optional coverage options could have on the NFIP.

The substitute amendment includes a compromise on residual risk under Section 107 commonly known as the "Cochran Compromise." The compromise provides the FEMA Administrator with the ability to waive the mandatory purchase requirement for residents in *de minimus* residual risk areas (defined as persons who would be assessed a premium of $1 per day or less). It also excludes communities protected by a flood control structure from additional mitigation requirements, recognizing that the investment in the flood control structure is a sufficient mitigation measure. The compromise also limits residual risk areas to areas behind a flood control structure, including a levee or dam, within the 100 year flood plain, thereby excluding anything that extends beyond that level. Finally, the compromise recognizes the level of protection provided by a flood control measure in assessing the premium, including allowing different levels of risk throughout the residual risk area. It also includes a study of the impact of including residual risk in the flood insurance program and a study to determine the feasibility of offering group flood insurance policies.

This title requires FEMA to establish a reserve fund to help cover losses in years where claims are higher than expected as compared to losses in average historical year loss.

Title II – Commission on Natural Catastrophe Risk Management and Insurance

This title establishes a nonpartisan Commission on Natural Catastrophe Risk Management and Insurance to examine the risks posed to the United States by natural catastrophes of all types and means for mitigating the risks posed by those catastrophes and paying for losses. The Commission will consist of 16 members, 2 appointed by the Senate Majority Leader, 2 by the Senate Minority Leader, 2 by the Speaker of the House, 2 by the Minority Leader of the House, 2 each by the Chair and Ranking Member of the Senate Banking Committee, and 2 each by the Chair and Ranking Member of the House Financial Services Committee, all of whom must have relevant expertise and not be government employees.

The Commission is to examine eighteen different issues related to natural catastrophes and mitigation, including insurance, and issue a report to the Senate Banking Committee and House Financial Services Committee within nine months on findings and assessments on those eighteen issues along with recommendations for legislative or administrative action.

Title III – Alternative Loss Allocation

This title, the Consumer Option for an Alternative System to Allocate Losses Act of 2012 or COASTAL Act, directs the Administrator of the National Oceanic and Atmospheric Administration to develop a Named Storm Event Model for determining the magnitude of winds, rainfall and storm surges associated with named storms. The Administrator, in consultation with the Secretary of Homeland Security, must identify named storms that reasonably constitute a threat to the coastal zone and develop a post-event assessment for such named storm. The Administrator must establish a specified protocol to collect and assemble all requisite data, which is largely currently available from NOAA, to produce post-event assessments, identify federal and state systems capable of collecting such data in consultation with the Office of Federal Coordinator for Meteorology, and establish the Coastal Wind and Water Event Database.

This title also directs the Comptroller General to audit federal efforts to collect this data and report on the audit to the Senate Committees on Banking and Commerce and the House Committees on Financial Services and Science, Space and Technology.

This title then directs the Administrator of FEMA to establish a standard formula for the proper assessment of qualified flood losses for claims for indeterminate losses, commonly known as slabs or total-loss properties, to properly cover qualified flood loss for claims for indeterminate losses while avoiding paying for losses caused by other perils under the national flood insurance program using the NOAA's post-storm assessment. The National Academy of Sciences shall evaluate the expected financial impact on the national flood insurance program of the formula established by this title and on the validity of the scientific assumptions that form the basis of the formula.

Finally, this title sets a maximum $1,000 civil penalty for any insurance claim adjuster who knowingly and willfully makes a false or inaccurate determination relating to an indeterminate loss.

Administration Position

As of June 20, 2012, the Administration has not issued a Statement of Administration Policy on S. 1940; however, the Administration issued a Statement of Administration Policy in support of the similar H.R. 1309.

Cost

On October 13, 2011, the Congressional Budget Office issued a cost estimate of the bill as reported out of Committee (which did not contain Title III or other changes) finding that the NFIP may borrow an additional $3 billion from the Treasury (the program's current debt stands at $17.8 billion) under both current law and S. 1940. Assuming some probability of a rare catastrophic event in the future, CBO expects that this borrowing authority will be exhausted in 2014. The changes made by the bill would improve the financial condition of the program and reduce its need to borrow from the Treasury–a source of direct spending–by a total of $380 million between 2012 and 2014. Because the program would continue to operate with insurance premiums that are not sufficient to cover all expected costs, CBO estimates that the NFIP would still need to borrow up to the statutory limit by 2015 and that reduced borrowing from 2012 to 2014 would be offset by increased borrowing in 2015, resulting in no net effect on direct spending over the next 10 years. Because enacting the legislation would affect direct spending and revenues, pay-as-you-go procedures apply. Under PAYGO procedures, CBO has estimated that this legislation will decrease the deficit by $10 million over ten years.

Over the 2012-2021 period, CBO estimates that the changes made by this legislation would increase net income to the NFIP by about $4.7 billion, improving the financial status of the program by that amount. However, under current law, the program will not have enough resources to pay all of the claims that will be due over that period. Therefore, it expects that additional income earned by the program would be used to fulfill obligations to flood insurance policyholders that would otherwise be delayed, resulting in no net effect on direct spending over the next 10 years.

CBO estimates that this legislation authorizes $2.2 billion through FY 2016 and $2.4 billion through FY 2021. This will result in nearly $1.6 billion in outlays through FY 2016 and $2.3 billion in outlays through FY 2021 mostly for FEMA's flood mapping program, subject to appropriation of the necessary and specified amounts.

Under current law, CBO estimates that delayed payments would total $3.6 billion by 2016 and $12.6 billion by 2021. Under this legislation, it estimates that the `backlog' would total $2.3 billion in 2016 and $8.0 billion in 2021, a reduction of about $1.3 billion and $4.7 billion, respectively.