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Maintain the best features of Biggert-Waters

By Howard Kunreuther and Erwann Michel-Kerjan

Flood insurance is hot on the Hill these days.

The 2012 Biggert-Waters Flood Insurance Reform Act (BW12) is a bold step by Congress to reform the federally run National Flood Insurance Program (NFIP). At a time when Congress was criticized for inaction, BW12 offered a counter-example: the bipartisan legislation – which was based on several years of discussions on Capitol Hill, Congressional hearings, public debate across the country and detailed empirical analysis of the NFIP – would ultimately help America become more resilient to future floods.

At its core, BW12 embodies two basic principles: one related to insurance—premiums should reflect the risk associated with future flood damage—and the other reflecting public policy concerns—the government should take steps to address affordability issues if premium increases create financial hardship for some residents in flood-prone areas.

There is indeed broad consensus that the NFIP cannot continue to operate as it has since its inception in 1968. Prior to the passage of BW12, the NFIP had been $18 billion in debt. Hurricane Sandy required the program to borrow an additional $9.7 billion to pay its claims--a debt largely caused by artificially low insurance premiums. These funds from Treasury represent taxpayers' money.

Insurance pricing that reflects risk will put the NFIP on more stable financial footing. It can also play an important role in signaling to those located in exposed areas the risks that they face. If premiums are artificially subsidized, homeowners and firms in flood-prone areas believe they are much safer than they actually are and might not invest in risk reduction measures. And many people are not dissuaded from moving to areas subject to flooding and hurricane damage because they underestimate the risk.

BW12 recognized that there would be great resistance to requiring risk-based premiums overnight and thus specified annual rate increases limited to 20 percent for those affected by the legislation. The Act also approves a study that is currently underway by the National Academy of Sciences to address options for dealing with affordability, such as means-tested vouchers, while moving toward risk-based premiums.

The legislation also authorizes FEMA to update old flood maps to more accurately reflect current flood risk. Those who are paying a lower premium as a result have been pleased. Those who will have to pay more for coverage have been very vocal and have pressured their elected officials to delay or repeal BW12.

But as we write this, Congress is moving towards legislation that will significantly modify the Act based on short-run considerations (election-year concerns) rather than focusing on the long-term goal of making America more resilient to future flood catastrophes and fiscal responsibility.

At the end of January 2014, the Senate passed a bill that would delay any premium increase for up to four years and allow homeowners to perpetually pass along their subsidized insurance premium if they sold their property, something that BW12 disallowed. On Tuesday night this week, the House voted its own version, HR 3370, that would, among other things, cap the maximum flood insurance premium at no more than one percent of a home's total coverage amount (e.g. $2,000 for $200,000 of coverage). As a result there will always be a gap between collected premiums and what is needed to pay for the claims of those who have a higher risk of flooding. HR 3370 is de facto asking American taxpayers to pay the difference. The House bill also proposes that subsidized flood insurance premiums increase annually from 5 percent to 18 percent but only to the point where the cap is not exceeded. For this reason many homes in flood-prone areas will never pay premiums that reflect the risk.

We urge Congress to consider the large body of evidence-based research on the overall performance of the NFIP with respect to the nature of the flood risk in the U.S., the role of mitigation, insurance coverage in place and claims payments before taking any final action to undo BW12. A few facts in this regard:

- Numerous residences across the country have a higher than 1% annual chance of flooding.
- Mitigation can make an enormous difference. Our recent analysis of thousands of homes located in Texas show that simply elevating them by 2 feet would reduce the expected flood losses in the future by 20 to 40%.
- Despite low premiums, many individuals are uninsured for flood even when they are required to have coverage. Six of 10 residential buildings in Parish County, Louisiana did not have flood insurance when Katrina hit. 8 out of 10 of those in areas inundated by Hurricane Sandy were uninsured.
- Those who purchase coverage (often after suffering flood losses or when buying a house) let their policies lapse 3 to 4 years later on average.
- Half of residential flood insurance claims over the period 1978-2012 were below $13,000 (corrected for inflation).

Based on these findings, we propose that Congress and the Administration integrate the following measures in future legislation:

- Delete the 1 percent cap provision on annual flood insurance premiums
- Target enforcement of the flood insurance requirement on federally-insured mortgages
- Require anyone in a flood plain to purchase basic insurance coverage, which is likely to be relatively inexpensive
- Specify rate increases of 10-18 percent per year so there is a longer glide path to risk-based premiums for many Americans than under BW12 and it takes 10 years or less to move to risk-based premiums.
- Address the affordability issue by providing government insurance vouchers based on income level (similar to food stamps), combined with grants and long-term loans to offset the upfront cost of loss reduction measures. The amount of the vouchers will be reduced when the property is made safer since the risk-based premiums would be lower.

Our country has suffered from an unprecedented series of devastating hurricanes and floods in the past decade. This pattern might very well be the new normal. If the forward-looking measures of BW12 are eliminated or postponed by new legislation we will have taken a step backwards in preparing America for natural disasters. Let's all be realistic about so-called short-term delays: nothing is more permanent than the temporary.

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