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NATIONAL FLOOD INSURANCE: THE END OF A PARTNERSHIP?

INTRODUCTION

Since 1969, home owners living in flood-prone areas of the country have been able to buy flood insurance from the National Flood Insurers Association, a group of private insurance companies, which is able to offer low premiums on flood insurance because of a partial subsidy by the Department of Housing and Urban Development. This unique government-industry partnership, which expires December 31, has proved an unqualified success, but now is threatened with extinction as HUD seeks to eliminate the private companies and take over complete control of the program. Nineteen congressmen have introduced H.R. 9585 which would extend the program through the spring of next year in order to give the Congress time to consider whether the current government-industry contract should be renewed. But the likelihood of any Congressional action is slim since leaders of both houses of Congress have stated that no new legislative business will be considered in 1977.

HISTORY OF THE FLOOD INSURANCE PROGRAM

In 1968 Congress passed the National Flood Insurance Act in order to provide an orderly method of dealing with flood disasters and to help cut the drain on the Treasury of billions of dollars of disaster relief. The act created a program whereby private insurance companies would sell flood insurance to home owners who live in flood-risk areas; the federal government would offer partial subsidies to keep the insurance premiums at a cost which

home owners could afford. In committee hearings before passage of the act, both Congress and HUD, which has executive authority over federal disaster programs, agreed that an industry program with federal financial assistance was the preferred means to insure that home owners could afford insurance. However, Part B of the act provides for an alternative program operated completely by the government if the government-industry partnership proves unworkable. The Federal Insurance Administration (FIA), an agency of HUD, contracted with the National Flood Insurance Insurers Association (NFIA), a consortium of 132 insurance companies, to sell and write the flood policies and administer the program.

As originally passed, the act provided that insurance would be available only in states which showed a "positive interest" in insurance and adopted land-use and control regulations to prevent unwise use of flood-prone land. Since NFIA's opportunities to sell insurance were limited by these restrictions, insurance sales grew at a slow pace in the early years of the program. Premium sales remained slow -- about 90,000 policies representing \$1.4 billion in coverage -- until the middle of 1972 when demand increased sharply. This increase was attributed to the widespread damage of Tropical Storm Agnes in June 1972 and to the easing of the entry restrictions by Congress.

As new communities have entered the program, NFIA has expanded its promotional activities through an agency sales force of 40,000 insurance agents and now has over 1.2 million policyholders representing \$34 billion of coverage throughout the nation. Under a revision of the flood insurance act passed by Congress in 1973, the private insurers are prohibited from receiving more than five percent profit, with any additional premium revenues going into a pool to reimburse future losses. The NFIA has realized a profit of only \$11.6 million since the program, an average of less than \$1.5 million per year to be divided among the 132 companies. From the beginning of the program in 1969 to June 30, 1977, NFIA has paid some \$220 million in claims, of which \$138 million has been paid in the last two years alone.

When setting up the program, Congress envisioned a year-by-year reduction and eventually an elimination of the government's financial subsidy. In the first year of operation of the program, the federal government paid 86 percent of the program's costs and losses. As the number of policyholders increased, however, the government's share of program costs and losses steadily declined to the point that the government's share of shareable costs and losses for the year beginning July 1, 1977, will be less than half. For the fiscal year, ending June 30, 1977, the total cost of the program was \$90,741,409; HUD's share of this total cost was 36 percent; and HUD's share of those costs shared by HUD and NFIA was 68 percent.

The government's incurred contribution to the program since its inception in 1968 has been 40 percent of the total incurred costs of the insurance aspect of the program. In the current partnership year (ending June 30, 1978), NFIA projects that HUD's share of total program costs will be approximately 27 percent, with 73 percent being covered, as ordinary insurance costs and losses are covered, by insurance premiums and investment income. In addition, NFIA member companies have underwritten the entire program with \$48 million of risk capital.

Flood insurance, which is not available in standard home owners policies, may be purchased from almost all state licensed property or casualty insurance agents under the NFIA plan. For residents of communities already in the program, there is a fifteen-day waiting period between the time the policy is purchased and the time it becomes effective. When a community first joins the program, there is no waiting period. The coverage pays for damages caused by flooding, mud flow, and flood-related erosion.

END OF A PARTNERSHIP

Despite this history of success, NFIA and HUD have been unable to agree on the terms of a new contract to extend the program. The two parties have negotiated for over eighteen months without success. NFIA's contract with HUD expires on December 31.

While negotiations for a new contract were going on, HUD insisted that it should have final say, a de facto veto, on all changes in the new agreement, plus a line-by-line approval of all NFIA expenditures. NFIA contended that such a setup would inhibit NFIA from carrying out its operational and management responsibilities. In effect, HUD's proposal converted the provisions of the contract to regulation form. HUD took all the provisions of the contract that NFIA had agreed to, added provisions that NFIA had not agreed to, and sought to impose still more new provisions on NFIA through regulation. What this meant was that the 1969 contract, as amended by HUD, would be binding on NFIA, but would be subject to unilateral amendment by HUD. Thus, HUD wanted to transform a contract between government and the insurance business into a system of regulations mandated by government. HUD Secretary Patricia Harris issued a take-it-or-leave-it ultimatum to NFIA in the summer, and threatened to institute Part B of the flood insurance act, that is, put the administration of flood insurance under complete government control.

The flood insurance act authorizes the Secretary to effect this change if the government-industry partnership proves "unworkable." The statutory provision requires HUD to take affirmative action including consultation with the industry and a special report to Congress, before assuming "in whole or part...the operational responsibility for flood insurance" under the program.

The House report to the original act indicates that only a failure of the cooperative program would justify a federally controlled program:

"The Secretary would be authorized to carry out the flood insurance program through...a government with industry aid, but only if absolutely necessary upon a failure of the government-industry program, and only after adequate notification to the Congress....

It cannot be too strongly emphasized by the committee that it is the government-industry pool that is the preferred vehicle."

The government-industry pool has been an unqualified success, but the negotiations for a new contract to continue that success have failed. Congressional reaction to Secretary Harris' decision has been negative. Thomas Ashley, chairman of the House Subcommittee on Housing and Community Development, the committee with oversight authority over the flood insurance program, and Garry Brown, ranking minority member of the subcommittee, sent a letter on September 20 to Secretary Harris requesting that she extend the program for 90-120 days past the expiration date of December 31 in order to give Congress the opportunity to examine if a switch to complete government control is warranted. The subcommittee had held hearings on the contract dispute at the beginning of September. The entire Louisiana Congressional delegation sent a letter to the Secretary requesting the same extension. In addition, seven members of the Senate Banking Committee wrote to the Secretary expressing their concern about the switch to a flood insurance program completely operated by the federal government.

On October 19, the disagreement over HUD's veto power over regulations was resolved to NFIA's satisfaction. Nevertheless, Secretary Harris, on November 2, communicated a thirty-days notice to Congress, as required by law, of her intention not to renew the partnership with NFIA. On November 4, Harris signed a preliminary contract with Electronic Data Systems to take over the actuarial administration of the program. EDS is not an insurance company and would take no financial risks. All management decisions would be made by HUD under the new arrangement. The contract would take effect on December 2 and the government-industry partnership would be dissolved.

In response to the imminent takeover by HUD, Congressman Garry Brown and eighteen cosponsors introduced H.R. 9585 on November 17, 1977. The bill would require Congressional approval of any determination by the Secretary of HUD to operate the flood insurance program under Part B of the flood insurance act. Since Congress is in recess, except for pro-forma sessions, and will not

take up any new business this year, it is highly unlikely that any action will be taken on the bill before the December 2 deadline. Because of this, no bill has been introduced in the Senate, although Senator Eagleton, Chairman of the Senate Subcommittee on Governmental Efficiency, sent a personal letter to President Carter requesting that the decision be delayed until Congress resumes normal sessions in January.

HUD claims that a government operated program, with the actuarial bookkeeping done by Electronic Data Systems, will save the government \$15 million per year. Both the House and Senate banking committees have questioned this conclusion and requested more time to evaluate such a claim. But it appears that nothing can stop HUD's determination to make the U.S. government an insurance agent. The process of transferring NFIA's data on over a million flood policies to the computers of Electronic Data Systems will be costly and time-consuming. Home owners insured under the current NFIA program will lose NFIA's experienced insurance management, NFIA's communication and distribution network with nearly 40,000 insurance agents and 3,000 claims adjusters, NFIA's established promotional capability designed to sell flood insurance policies and NFIA's insurance expertise drawn from 132 insurance companies at no cost to the current program. HUD's Federal Insurance Administration will have to quickly make up for these losses in order to continue the smooth operation of flood coverage. Whether HUD, starting from scratch, can provide all the current services and still save \$15 million over the current program can only be proved by time.

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