GAO Highlights

Highlights of GAO-16-611, a report to the Chairman, Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U. S. Senate

Why GAO Did This Study

NFIP was created, in part, because private insurers historically have been unwilling to insure against flood damage. The private flood insurance market remains small. The 2012 Biggert-Waters Act took steps to encourage private-sector participation by requiring regulators to direct lenders to accept private flood insurance to satisfy the mandatory purchase requirement—a federal requirement to purchase flood insurance on certain properties.

GAO was asked to examine if the regulatory environment posed barriers to private flood insurance. This report describes (1) lender and regulator implementation of provisions on private flood insurance; and (2) views on regulatory, or other, barriers to using private flood insurance to satisfy the mandatory purchase requirement. GAO reviewed laws, regulations and guidance and interviewed officials from FEMA, five federal regulators, government-sponsored enterprises, and the National Association of Insurance Commissioners. GAO interviewed various stakeholders, selected based on their flood insurance experience and size, among other factors: a nongeneralizable sample of eight lenders; 13 organizations; five state insurance regulators; and four private flood insurers.

What GAO Recommends

GAO recommends that FEMA reconsider allowing policyholders who cancel their NFIP policy to be refunded, on a prorated basis, when obtaining a non-NFIP policy and take any necessary steps to amend the NFIP standard policy to do so. FEMA agreed with our recommendation.

View GAO-16-611. For more information, contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov.

July 2016

FLOOD INSURANCE

Potential Barriers Cited to Increased Use of Private Insurance

What GAO Found

Lenders and their regulators have taken some action to implement provisions on private flood insurance in the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters Act). Specifically, lenders told GAO they send notifications to borrowers that encourage borrowers to compare private and National Flood Insurance Program (NFIP) policies. Lenders with whom GAO spoke accepted private policies and generally said they used Federal Emergency Management Agency (FEMA) guidelines and interagency guidance to evaluate private policies. Federal regulators (Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, National Credit Union Administration, and Farm Credit Administration) issued interagency questions and answers on private insurance in 2009, which cite the FEMA guidelines. However, FEMA rescinded its guidelines in 2013, citing a lack of authority to rule on the acceptability of private insurance policies. Federal regulators have issued joint proposed rules to implement the Biggert-Waters Act definition of private flood insurance, but have not yet finalized them. Regulators stated that the information provided in the 2009 Questions and Answers remains in effect until final rules implementing the private flood insurance provisions of the Biggert-Waters Act are adopted.

Stakeholders cited a number of challenges as potentially inhibiting the use of private flood insurance to satisfy the mandatory purchase requirement.

- **Regulatory uncertainty**. Without final regulations implementing the Biggert-Waters Act requirement to accept private flood insurance, there was uncertainty among stakeholders about which private policies would satisfy the mandatory purchase requirement. Many stakeholders, including some lenders, emphasized that lenders needed discretion when evaluating policies and that ensuring policies met the Biggert-Waters Act definition would be challenging for lenders, in part due to their lack of insurance expertise.
- **Recent NFIP changes**. Stakeholders noted that a recent NFIP policy change could discourage consumers' use of private insurance. FEMA recently stopped allowing policyholders to obtain a refund of their unused NFIP premium if they obtained a non-NFIP policy. FEMA officials stated that, based on their recent review of NFIP cancellation policies, this practice was not explicitly permitted in the NFIP standard flood insurance policy terms and conditions. Due to this change, consumers who wish to obtain private coverage would forfeit any unused portion of their premium if they switched after the NFIP policy's effective date. While FEMA's standard policy terms do not specifically address refunds when a non-NFIP policy is obtained, FEMA could revise the standard policy to allow for such refunds. Allowing this type of refund would be in line with industry practice to allow refunds of paid premiums when cancelling insurance policies, as well as Congressional interest in transferring some of the federal government's exposure to flood insurance risk to the private sector.
- **Market challenges**. Many stakeholders noted that low private sector participation in flood insurance was also due to market challenges, some citing the inability to compete with discounted NFIP rates as a primary barrier—a finding that GAO also reported in previous work (GAO-14-127).