GAO Highlights

Highlights of GAO-13-568, a report to congressional committees

July 2013

FLOOD INSURANCE

Implications of Changing Coverage Limits and Expanding Coverage

Why GAO Did This Study

NFIP was created in 1968 and is the only federal flood insurance available. It may be the sole source of insurance to some residents of flood-prone areas. Mainly due to catastrophic losses in 2005, the program became indebted to the U.S. Treasury and has been unable to repay this debt. Because of NFIP's financial instability and management challenges, GAO placed the program on its High-Risk List in 2006. The Biggert-Waters Flood Insurance Reform Act of 2012 introduced many changes to the program and mandates GAO to study the effects of increasing the maximum coverage limits ($250,000 for residential buildings and $500,000 for commercial buildings) and providing optional coverage for business interruption and additional living expenses. This report discusses (1) existing flood insurance coverage, (2) the potential effects of changing NFIP coverage limits, and (3) the potential effects of allowing NFIP to offer optional coverage for business interruption and additional living expenses. To address these objectives, GAO analyzed data from NFIP's databases of policies and claims, reviewed prior reports, and interviewed brokers, insurers, and representatives from consumer advocacy and industry organizations.

What GAO Recommends

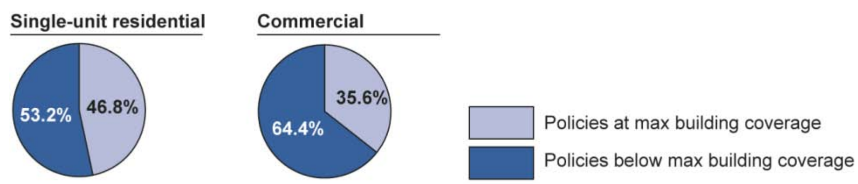
GAO continues to support previous recommendations to the Federal Emergency Management Agency (FEMA) that address the need to ensure that the methods and data used to set NFIP rates accurately reflect the risk of losses from flooding. FEMA agreed and has taken some steps to begin to implement them.

View GAO-13-568. For more information, contact Alicia Puente Cackley, 202-512-8678, or cackleya@gao.gov.

What GAO Found

The National Flood Insurance Program (NFIP) currently has more than 5.5 million policyholders insured for about $1.3 trillion who pay about $3.5 billion in annual premiums, but less than half purchase maximum coverage—a possible indicator of how many might purchase additional coverage were it offered. However, from 2002 through 2012, the proportion of residential and commercial policies at maximum building coverage rose substantially—from 11 to 42 percent and from 21 to 36 percent, respectively. States along the Gulf and East Coasts have the most residential policyholders with maximum coverage. In addition, states with higher median home values generally have a higher percentage of policyholders purchasing coverage up to the limit. Industry stakeholders said that an unknown number of policyholders with higher-value properties choose to purchase additional, or excess, coverage above the NFIP limit through the private flood insurance market—a small and selective group of insurers.

Percentage of Residential Single-Unit and Commercial Policyholders with Maximum Building Coverage, as of September 2012



Source: GAO analysis of NFIP's Database of Policies.

Increasing coverage limits could increase the net revenue of the program and have varying effects on NFIP, the private insurance market, and consumers. Assuming that higher coverage limits had been in effect from 2002 through 2011, GAO's analysis suggests that NFIP still would have suffered losses during years with catastrophic floods, such as 2004 and 2005, but would have experienced net increases in revenue in other years. Such increases could have offset future losses or helped avoid additional debt, but the overall financial impact and risk to the program would depend on the adequacy of the rates charged, which GAO has questioned in the past, and the number of policyholders opting for additional coverage. Regarding the private flood insurance market and consumers, higher NFIP coverage limits could decrease participating insurers' overall risk exposure and provide more options to consumers, but might lessen participation of private insurers, as consumers might need to purchase less private insurance.

Adding optional coverage to NFIP for business interruption and additional living expenses could result in less uninsured risk in the market, but further negatively impact the financial stability of the program. Industry stakeholders told GAO that business interruption coverage is generally purchased by only larger companies, as its high cost prohibits small- and medium-sized companies from being able to afford it. In addition, adding business interruption coverage to NFIP could be particularly challenging. For example, properly pricing risk, underwriting, and claim processing can be complex. NFIP officials have stated that they would have to hire additional expertise in-house to offer this coverage. Similarly, offering optional coverage for additional living expenses has many of the same potential effects on NFIP, the private market, and consumers, although this coverage is generally less complex to administer.