National Flood Insurance Program (NFIP)

An Illustration of the Benefits of Private Market Depopulation and Reinsurance Risk Transfer

The NFIP can significantly improve its long-term financial strength and substantially reduce the risk to taxpayers through a combination of depopulation (*i.e.*, the assumption of existing NFIP policies by private insurers) and the purchase of reinsurance.

The chart below illustrates the financial projections for the NFIP from year-end 2016 to 2020, based on the recent experience of Florida Citizens' Insurance Corporation, which successfully reduced both its policy count and the risk to Florida taxpayers. We conclude that a combination of (1) the private market depopulation of NFIP policies, (2) currently-anticipated NFIP rate changes and (3) reinsurance purchases similar in scale to those undertaken by Florida Citizen's would result in a 31% decrease in the NFIP's exposures and a 91% decrease of the additional Treasury financing required to pay the losses for floods that have a 1% chance of occurring this year (1 in a 100-year flood.) We estimate these substantial reductions in risk will result in only a 10% decrease in premiums collected by the NFIP from the 2016 Projection. [i]

NFIP	Projection: Year End 2016	Projection: 2020 Private Market Depopulation Similar to Florida Citizens & Reinsurance Purchase	Projection 2016 to 2020
Earned Premium (EP) in millions	3,500	3,161	-10%
Earned Exposures in millions	5.1	3.5	-31%
	% of EP	% of EP	
Expected Loss & ALAE Ratio	80%	63%	
Expense Ratio	38%	49%	
Combined Ratio	118%	112%	
Additional Financing Required from Taxpayers to Pay Losses in millions			
250 year	16,752	5,527	-67%
100 Year	9,952	865	-91%
50 Year	5,252	0	-100%

Note: Additional Financing Required to Pay Losses is the Net Loss after the NFIP Cash Balance, Reserve Fund, Private Reinsurance and the Borrowing Limit

A Success Story--Florida Citizen's Experience

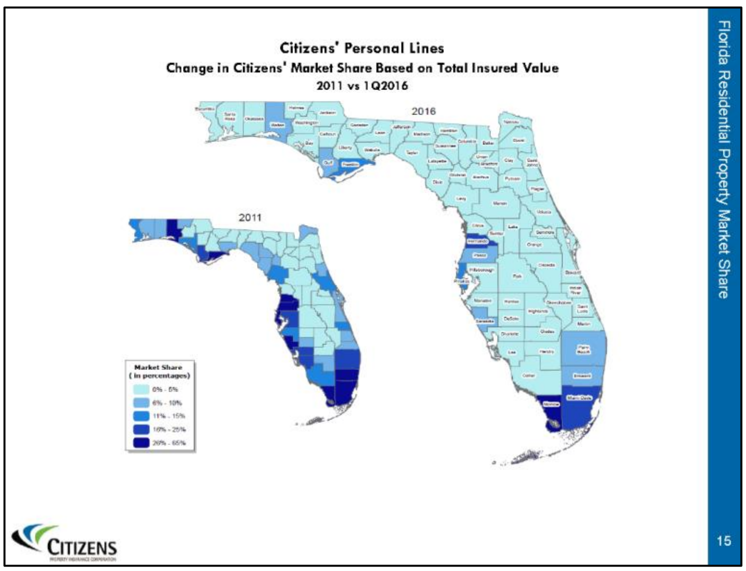
Florida Citizens Property Insurance Corporation, a state-sponsored entity that provides homeowners insurance, is a recent example of a successful private market depopulation and reinsurance risk transfer program. Combined with gradual rate increases, these actions decreased the exposure of and liabilities to Citizens from 2011 to 2016, allowing Citizens to significantly improve its financial performance.

Citizens	2011	2016	2011 to 2016
Written Premium in millions	2,473	578	-77%
Earned Exposures in millions	1.5	0.5	-66%
Additional Financing Required from Taxpayers to Pay Losses in millions			
250 year	20,913	2,814	-87%
100 Year	6,402	0	-100%
50 Year	12	0	-100%

Note: Additional Financing Required to Pay Losses is the Net Loss after FHCF, Private Reinsurance, Catastrophe Bonds and Surplus

The illustration presumes the private market appetite for flood policies that are currently written by the NFIP is expected to be similar to that for Florida Citizens. The majority of the policies assumed by the private market were coastal wind exposed policies where the premium exceeded the losses and expenses, *i.e.*, that had a reasonable expectation of profit. The private market is not expected to compete for policies where the premium is perceived to be inadequate.

The chart below maps the decrease of Citizens policies by county.



https://www.citizensfla.com/documents/20702/93160/20160331+Market+Share+Report/ab841adc-d5fb-45ca-bff6-8dbd15d5cac5

Conclusion

This illustration demonstrates that a reduction in NFIP policy count and aggregate exposure to catastrophic events by permitting private insurers to select and underwrite risks, combined with the use of reinsurance to manage the resulting catastrophic risk, can and will strengthen the financial condition of the NFIP and its ability to withstand extreme flooding events without burdening taxpayers.

While the analysis is not a prediction of the future, the private insurance and reinsurance markets have demonstrated that they are willing to underwrite difficult risks, such as wind or flood. Policymakers should continue to encourage and incentivize private insurance and reinsurance underwriting to compete along with the NFIP, supplement the NFIP's writings, and help the NFIP manage its risk and protect taxpayers.

Notes: The “projections” and time frames noted in the illustration are a “what if” analysis based upon an extrapolation of the experience of Florida’s Citizens Property Insurance Corporation. The illustration is intended to demonstrate that the utilization of a facilitated depopulation program and reinsurance to reduce the NFIP policy count and aggregate exposure would enhance, not weaken, the NFIP financial condition.

Because Florida Citizens depopulation was a rapid, unqualified success, this illustration makes the assumption that the percentage decrease of exposures and losses at the NFIP will as half of what Citizens experience during a similar timeframe.

Despite such conservatism in the financial projection, as the private flood insurance market for residential homeowners is newly emerging, and because there are currently structural impediments to private market competition with the NFIP and the acceptance of private flood insurance by lending organizations, the time frames over which the NFIP policy count would be significantly reduced by private market competition is likely to be overstated. Action by Congress and the Administration to facilitate the ability of the private insurance market to compete with the NFIP and be accepted by lenders would accelerate the market development and reduce any such overstatement.

All assumptions assume the NFIP rates continue to increase as anticipated, there is no appreciable change in the underlying exposures of the NFIP portfolio, the expected losses are the losses the NFIP incurs every year and the interest on the Treasury loans and other expenses change remain relatively static. In actuality, we expect the annual losses to be volatile from year to year, causing some years to result in extra money to decrease the principal on the Treasury loans and other years where the NFIP may have to access additional funds from the borrowing authority, increasing the interest due on the Treasury loans. All year end 2016 expenses and losses were projected from data within www.fema.gov, bsa.nfipstat.fema.gov, “Reinsuring NFIP Insurance Risk and Options for Privatizing the NFIP Report“, "Actuarial Rate Review in support of the recommended Oct 1 2011 Rate and Rule Changes" & "Information About NFIP Treasury Borrowing."

The 2016 and 2020 projections are not intended to be projected loss estimates to be used for rate setting. The projections are based on aggregated publically available information and trending assumptions. It is assumed the NFIP has better detailed exposure, loss and expense data to make a rate projection. This exercise is intended to demonstrate how the exposures, premium, expected losses, PMLs, reserve funds and borrowing authority change based on the rate increases mandated as of today, the potential for private market activity and the effect of reinsurance being purchased.

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