Rethinking the NFIP: Straw Man Policy Options

Privatization Policy Options

Description of Policy Theme:

Is there a new role for the private sector?

There are various alternatives for turning to the private market to address flood losses including privatization of the entire program or privatization of elements of the program (enforcement, risk identification, mitigation, insurance). We recognize that the exact approach or solution for each alternative will depend upon the market's willingness and capability to assume a particular role. Until robust dialogues are held with relevant market players, a truly feasible solution cannot be clearly defined. Nevertheless, we offer some options to provide a flavor on how the alternative could be implemented.

One of the drivers for the enactment of the National Flood Insurance Act (NFIA) and establishment of the National Flood Insurance Program (NFIP) was the failure of the private market to provide any substantive means, by insurance or otherwise, to mitigate the flood hazard risk. Many hurdles stood in the way at the time: the areas prone to flood hazard and the likelihood of flooding had not been identified, building practices and codes that mitigate the flood hazard were not known or not enforced, and the financial risk of insuring properties with the potential for large catastrophic loses posed an unmanageable threat to the solvency of insurers. Now, 40 years later, many of these barriers have been addressed. The Federal Government has produced updated flood hazard data for more than 92 percent of the Nation's population, more than 21,000 communities adhere to minimum building and land use criteria, and various financial instruments could be explored that could help manage insurers' risks such as disaster bonds and auctioning risk. We must ask ourselves, is it possible for the private sector to pick up from where we are now and provide a better solution to the problem of flood losses?

Straw Man Policy Options:

- **Full Privatization:** The Federal Government would not be involved at all in the servicing and backing of flood insurance. The private market is left to enforce land use and building practices and mitigation would be funded by private markets. Federal disaster policy may be used to ensure future publicly funded disaster recovery occurs only in locations where minimum standards are implemented.

- **Privatize with Federal Assistance:** Full privatization may not be feasible if the private sector is unwilling or unable to assume all aspects necessary to mitigate the flood hazard effectively for the Nation as a whole. However, many of the functions of the existing NFIP could be moved completely to the private sector with the Federal Government's role reduced to providing guidance, setting minimum standards, and offering incentives (including financial backing).

- **Federal Role Limited to Special Classes of Population:** Under this option, the private market delivers all aspects of floodplain management including insurance, risk analysis, and building standards. The Federal Government's role is limited to those situations where intervention is deemed necessary to address market failures adversely affecting special classes of populations such as low-income populations or populations in particularly hazardous areas.

- **Reinsurance:** The Federal Government assumes a catastrophic loss reinsurer role where reinsurance is triggered by a loss amount or a particular flood disaster size. In the alternative, the Federal Government may sell the first line of flood insurance and pay a reinsurance premium to the private sector to take on losses exceeding a loss amount or based on a particular flood disaster size.

- **Financial Instruments:** Regardless of the policy alternative chosen for the NFIP Reform initiative, private-sector financial instruments can aid in reducing the volatility of flood losses (flatten the payout curve) or raise money for flood mitigation, recovery, or insurance. Financial instruments can also help improve fiscal soundness and planning for flood loss so that limited borrowing or emergency aid is required in excess of annual budgets. Instruments include disaster bonds, auctioning of risks (derivatives), and investment of insurance float.