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NCIP NATURAL CATASTROPHE INSURANCE PROGRAM

POULTON ASSOCIATES LLC

Drowning Under Artificially Low Rates:

Analysis of NFIP Data Demonstrates Unsustainable Rates and Increasing Taxpayer Burden

Comprehensive Study Conducted in Conjunction with the Scientists at Hazard Hub

HazardHub

EXECUTIVE SUMMARY

NFIP rates have not increased in line with expectations set forth in the Biggert-Waters Flood Insurance Reform Act or the Homeowners Flood Insurance Availability Act. In fact, the NFIPs average annual rate today continues to be significantly below the 2014 rate. The NFIP's currently anticipated increases in their average annual rate will lead to continued skyrocketing losses for taxpayers. The failure to increase rates in a meaningful way has resulted in even larger losses to the program, lack of private insurance options for consumers, and continued environmental damage from subsidized property development in flood prone areas.

Using the most recent data available, Poulton Associates, LLC, partnered with Guidewire Software's HazardHub team to review the change in average policy rate charged by the National Flood Insurance Program (NFIP) over the past decade. For this report, analysts at Poulton Associates, who specializes in private flood insurance at www.CATcoverage.com, and the scientists at HazardHub, who work to translate geospatial data and provide property hazard risk databases, reviewed NFIP data.

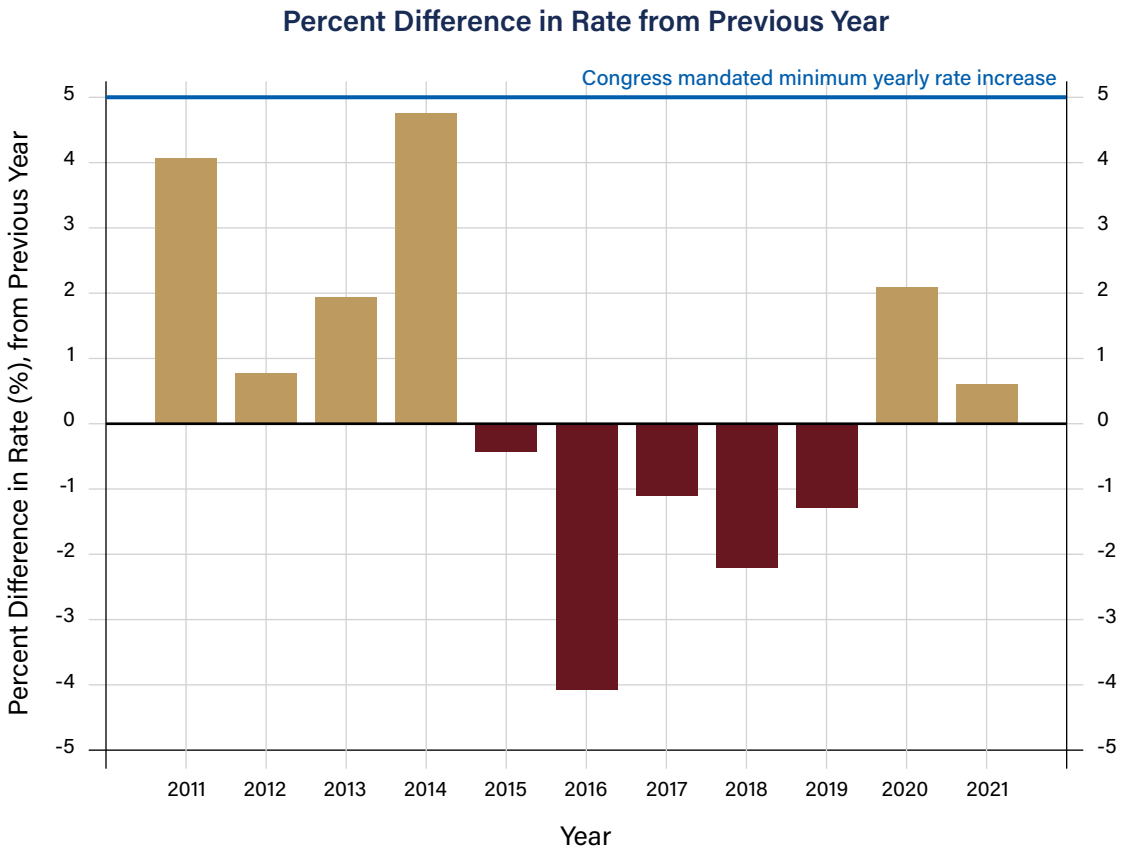
HISTORY AND ANALYSIS

The NFIP was originally designed to provide affordable insurance for buildings and contents located in the 100-year floodplain. Federally regulated mortgage lenders are required to have their customers purchase flood insurance if their properties are located in the floodplain. The original program, the National Flood Insurance Act of 1968, was designed as a temporary reinsurance mechanism for private flood insurance. The long-term vision was to facilitate a fully private flood insurance market. Over the past several decades, numerous floods have reached far beyond the 100-year limit, affecting areas in the 500-year floodplain and beyond. In addition, land developers have successfully lobbied to move the boundaries of floodplains to allow for more profitable development. This has resulted in a concentration of property values in areas exposed to catastrophic flooding along with the destruction of natural habitats.

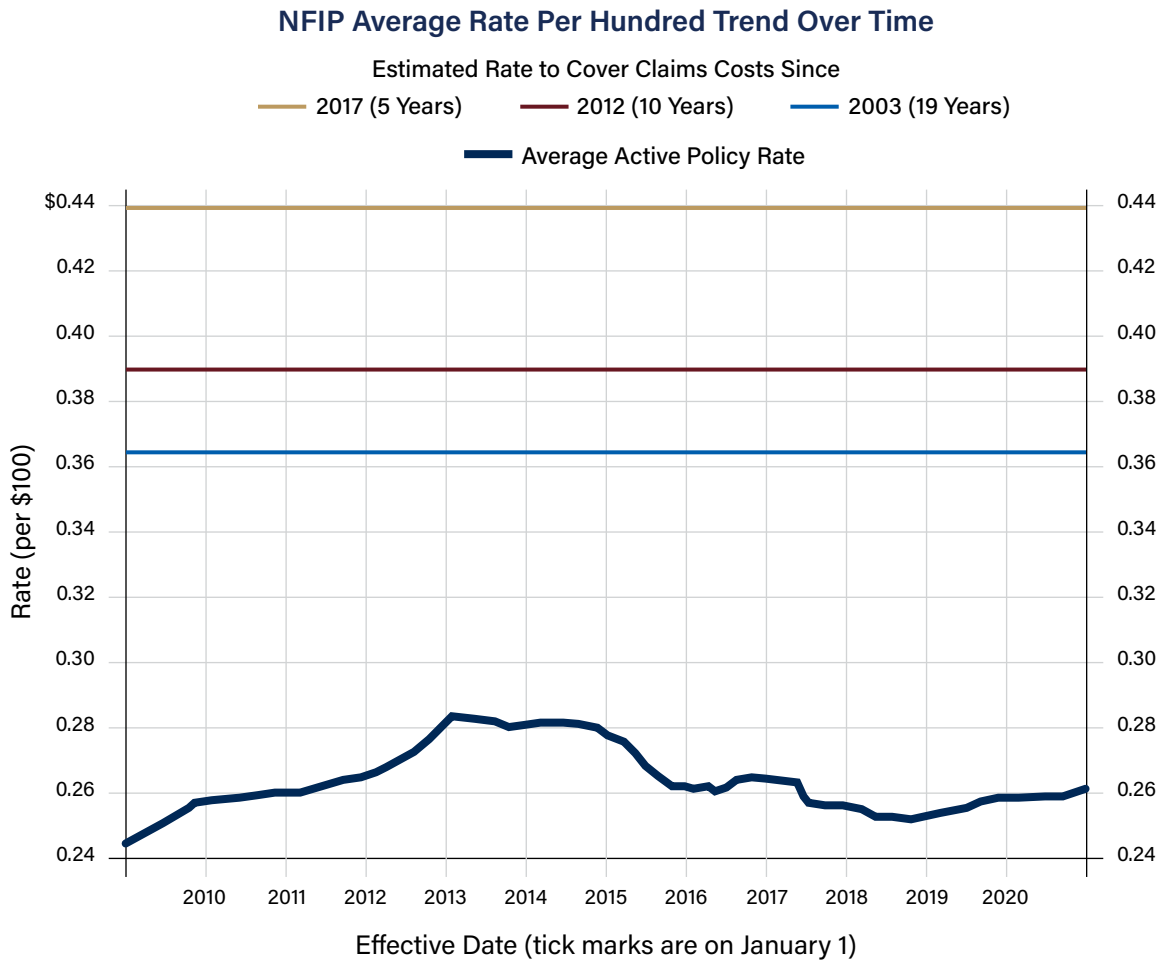
In passing the Homeowners Flood Insurance Affordability Act in 2014, Congress charged FEMA to raise NFIP rates for the overwhelming majority of structures by at least 5%, but not more than 18% with some exceptions. The hope was that the legislation would:

1. Slow the NFIP's accumulation of public debt, which has cost taxpayers almost $1 billion per year on average since 1980.
2. Stop incentivizing development on flood-prone lands through unreasonably low flood insurance rates.
3. Help protect environmentally sensitive areas.

Unfortunately, our research shows NFIP rates follow a different trajectory. While the figure below illustrates year-over-year rates increased from 2011 through 2014, this pattern did not continue. From 2015 through 2019 the year-over-year rates decreased, followed by small increases the next two years.



The NFIP average annual rate has trended down from 27.8 cents per hundred at the start of 2014 to 25.3 cents by the start of 2019, a 9% decrease. The figure below shows the average effective policy rate by day compared to rates necessary to cover historical claim costs. Not only have average rates stagnated over the last decade, they are almost half what was needed to cover claims costs over the same period.



CONCLUSIONS

This analysis demonstrates the NFIP continues to significantly undercharge for flood insurance despite repeated instructions to the contrary by Congress.

Because the NFIP failed to raise rates when instructed, a series of negative outcomes have been exacerbated, including:

- To cover its losses, the NFIP continues to borrow from the U.S. Treasury and receive debt forgiveness, leaving a cumulative burden on the taxpayer of nearly $38 billion and counting.
- The artificially low rates for flood insurance constitute a denial of climate change, incentivize the continued development of flood-prone lands and facilitate the destruction of natural habitat.
- These low rates create disincentives for the private market to compete in ways that would facilitate consumer choice in flood insurance and help to remove the financial burden from the taxpayer.

In recognition of its shortcomings, the NFIP implemented Risk Rating 2.0 in April 2021. But by our analysis, the current implementation of Risk Rating 2.0 will fail to align with risk.

The NFIP has designed Risk Rating 2.0 to deliver an average annual premium rate only marginally higher than the existing 26 cent rate. After 5 years with the program in force, Risk Rating 2.0 will achieve an actuarily defensible rate applicable to only 50% of customers.

Considering that mandated rate increases are not reflected in the actual rates charged by the NFIP over the last 10 years, combined with extraordinarily rapid construction cost inflation, the NFIP will need to increase rates at a dramatically faster pace than Risk Rating 2.0 now anticipates if there is to be a semblance of equity in the new rate structure. Rate increases much higher than 5% or 10% per year will almost certainly be needed just to keep up with rapidly trending upward inflation – let alone make progress toward adequate rates.

RECOMMENDATIONS

With a greater focus on rate adequacy, and fairness to consumers, the NFIP can work in tandem with the private market to improve the flood insurance marketplace. As Congress weighs flood insurance reform, it should consider the following:

- Force the NFIP to implement Risk Rating 2.0 rate increases at a higher rate and at a faster pace than has been outlined to ensure rates are actuarily sound and fair for policyholders and taxpayers.
- Eradicate the mid-term cancellation rule that denies policyholders the opportunity to cancel their NFIP policy in exchange for a private market policy at the time of their choosing – and be eligible for a refund of the remaining premium. Risk Rating 2.0 is going to raise rates for many people and those policyholders are going to want to shop for better rates. They should be free to lock in a better deal at their convenience, not just during their NFIP renewal window.
- Require the NFIP to develop flood maps that more accurately define today's flood zones. NFIP flood maps are greatly outdated and provide a false sense of comfort to too many homebuyers. We have to disincentivize people from moving into areas that are flooding, not encourage the practice with artificially low flood insurance rates.
- Mandate the NFIP to release property-level (rather than census tract aggregate) loss data so buyers can make informed decisions before buying homes and so insurers can accurately price flood risk.

METHODOLOGY

The OpenFEMA 'Redacted Policies' data (FIMA NFIP Redacted Policies - v1 | FEMA.gov, CSV downloaded February 18, 2022, containing 60,536,765 rows, labeled "Last Data Refresh: 01-24-2022") contains policy information dating to 2009. Within that document are individual rows of policies with their effective and termination dates, policy cost, premium, federal policy fee (FPF), policy count and policy coverages (labeled in the data set as policyEffectiveDate, policyTeminationDate, policyCost, totalInsurancePremiumOfThePolicy, federalPolicyFee, policyCount, totalBuildingInsuranceCoverage and totalContentsInsuranceCoverage, respectively).

Each figure used the policy effective date for the x-axis. The first figure 'year' represents the year of the policy effective date. For the second figure, an active policy was defined as a policy that was effective before or on that day and was terminated after or on that day. Total Coverage was the sum of building plus contents coverages for each policy. The policy cost, premium, FPF, count and Total Coverage of all active policies were summed for each year. The rate was calculated by multiplying 100 by premium divided by Total Coverage.

Estimates of losses were calculated from the Department of Homeland Securities Financial Reports, also called Performance and Accountability Report for the earliest reports available in 2003 through 2006 (from Performance & Financial Reports | Homeland Security (dhs.gov)). Within the report, the column "Gross Program Costs," was cumulatively summed, starting with the 2021 value going to 2003. To correct for anticipated Hurricane Ida losses, $3 billion was added to the 2021 value. The Total Coverage values were described above. For 2003 to 2008, an average of the Total Coverages from 2009 through 2021 was used, even though this is a likely overestimate. The Total Coverages were cumulatively summed, starting with the 2021 value going to 2003. The calculation of rate was then 100 times the cumulative "Gross Program Costs" divided by the cumulative Total Coverage.

CRAIG K. POULTON

Craig Poulton is chief executive officer of Salt Lake City-based Poulton Associates, LLC, which administers the country's largest private flood insurance program, the Natural Catastrophe Insurance Program available at www.CATcoverage.com.

As CEO of Poulton Associates, Craig is responsible for creating and moving his organization to the electronic distribution of catastrophe-related insurance products and developed the Natural Catastrophe Insurance Program as the first private market online alternative to the National Flood Insurance Program. It is now used by more than 10,000 insurance sales organizations and more than 25,000 insurance sales professionals across the country and insures billions of dollars of property against the peril of flood.

An insurance broker for more than 40 years, he holds the professional designation of Certified Insurance Counselor and holds insurance licenses in all 50 states. As a member of the Independent Insurance Agents of America, he has represented the state of Utah on the Acord Standards Committee and has been widely cited and quoted in national media and insurance industry trade publications. He recently served as a member of the Editorial Advisory Board for National Underwriter/PC360.

Poulton Associates was featured six times in the 2016, 2017, 2018 and 2019, 2020 and 2021 Inc. magazine lists of the 5,000 fastest growing companies in America – a rare accomplishment according to the magazine. Craig has a Bachelor of Science degree in communications with an emphasis in finance from the University of Utah.

BOB FRADY

Bob Frady decided to start HazardHub when a friend's home unexpectedly flooded. "They were not in a flood zone but were right next to one. It was easy to see if you had the right tools. With HazardHub, we want to make those tools available to every single homeowner in the United States. While we can't prevent disasters from happening, we can give you a leg up in preparation. Bob is an expert audience builder and sharpened his teeth at leading edge brands like Live Nation, Expedia and Zeeto Media. Bob also oversees our flagship consumer site, www.freehomerisk.com.

Poulton Associates LLC

Poulton Associates, LLC is a Utah-based managing general agent and insurance brokerage with expertise in property and casualty insurance. As administrator of the Natural Catastrophe Insurance Program, they make the program available to insurance professionals in all 50 states at www.CATcoverage.com.

HazardHub

HazardHub, a part of Guidewire Software, has emerged as a leading provider of property hazard data and risk scores in the U.S. HazardHub delivers an innovative offering that models complex natural and manmade phenomena to drive decisions that benefit insurers and insureds. HazardHub powers decisions for 110+ customers, spanning insurers, reinsurers, brokers, MGAs, and insurtechs. For more information, please visit https://www.guidewire.com/products/hazardhub/.