Harvey and the Flood Insurance Imperative

When Our Industry can be a Stronger Force for Good than a Government

By Bill Martin, CEO of Plymouth Rock Property Assurance, co-founder Neptune Flood

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As we watch the pain and heroism experienced by our neighbors in Houston, it is hard not to respect the extraordinary force of nature as well as our human ability to respond. Our attempts to influence extreme weather or protect against catastrophes seems like a small inflatable raft in Maverick's surf… we struggle to stay afloat, hoping for a better raft.

Over the weeks to come, our industry will miss a rare opportunity to show how we can help. Why? We opted out of the flood business. Insurers called it an "uninsurable risk" half a century ago. Yet, half a century ago, we did not have detailed data on structures by location. We did not collect detail on much contractors spend to repair or replace damaged property. We hadn't developed advanced technology and data-driven models showing what happens when water is dumped or pushed into our towns and cities. We did not have carefully mapped land shapes and elevation through satellite and LIDAR.

Half a century ago, insurance carriers had not built wealth by transferring extreme risk from policyholders to global capital markets. In 50 years, insurers have learned more about what customers need after an event and what it costs to provide it. We are willing to sell that coverage to customers at a price that is half or less of what a lifetime of savings could pay for. We offer peace of mind and savings that can only be delivered through global risk sharing pools.

We are approaching NFIP's half century anniversary. It is time to grow up.

This year, the capital available to finance recovery from catastrophic events will likely pass $600 billion. This does not include the amount of money domestic property carriers are willing to risk in an event using their $100 billion in personal property insurance revenues per year. Fifty years ago, property insurance prices were not adequate to cover long term catastrophic exposure. Carriers did not know how to put a price on coverage or rare, extreme and concentrated disaster events.

Early estimates of flood damage are in the $10 billion range. The National Flood Insurance Program (NFIP) collects $3 billion per year. In order to not run a deficit on losses alone (forget administrative and sales expense), the NFIP would have to triple rates for the average customer to avoid a deficit after Harvey. At least half the customers representing less than half the property values insured can't afford that increase.

Customers who can afford the increase should not be subsidized with tax dollars .That is not risk sharing -- that is risk transfer from the wealthy to those with more modest means. Those who can afford it should either rebuild and buy more resilient real estate or pay the price.

Let's be pessimistic... though not unrealistic. Let's assume the active 2017 storm season will create more than $30 billion in flood damage. The result would double the NFIP deficit and require tenfold average rate increases to cover costs. That is not going to happen.

For the global capital markets, $30 billion is only 5% of capital at risk – maybe 15% of average annual revenues. For them, Harvey is painful… but a nit. It is the reason reinsurance companies exist. It could be the reason we no longer risk a government program's failure.

There are those who say privatizing flood for those who can afford it or those with low risk will result in a less financially sound NFIP. That is baloney and bad math. What is creating financial problems in the NFIP is risk aggregation – the fact they insure practically everyone who owns property in Houston or the Jersey Shore or New Orleans. Global capital markets let you spread catastrophe risk across the world, thus combining and financing 250-year storms over 250 years… something that is impossible to do within any one correlated geography or risk segment.

When the NFIP was created, it was designed to fund flood damage mitigation. The program provides community incentives in the form of rate credits, but has had little capacity to directly finance such projects – in part because of the deficit created by its aggregate exposure to extreme events. Since then, the amount of insured value in recognized flood hazard zones, the value insured by the NFIP has gone up seven-fold. Mitigation is not reducing our exposure to deficits.

Underpriced NFIP rates for new construction in known flood-prone zones are actually subsidizing the value of properties built at the coast. Even as we improve building codes and restrict development in coastal communities, sea levels rise to new heights. The value of property in 100 year flood zones has tripled. We need to shore up the money available when such trends result in catastrophic loss… before the next Harvey.

Raise NFIP rates to risk-driven levels for those who can afford it. Allow private underwriters to compete aggressively, including taking out groups of customers carriers are willing to offer lower prices for the same risk. Reduce aggregation. Let the NFIP and private carriers spread the risk globally and stop the regular game of chicken called reauthorization. Be affordable only for those who can't afford it. Subsidize those of modest means or high risk, using coming surpluses (once aggregation risk is eliminated) to rebuild safer homes.

Grow up. Stop whining. Solve the problem. Fight the force of nature with strength and power of our extraordinary insurance industry.