POLICY #1: INCLUDING FLOOD IN HOMEOWNERS INSURANCE POLICIES

This policy work group will explore the feasibility and potential impact of including flood insurance coverage in the standard homeowners insurance policy.

The Issue

In the U.S., standard homeowners insurance policies do not cover flood damage. Unfortunately, many homeowners fail to realize this, do not purchase flood insurance, and struggle to pay for costly repairs when their homes are inundated.

Homeowners can buy flood insurance from the National Flood Insurance Program (NFIP) and private carriers have recently begun to offer flood coverage. Both the NFIP and private firms offer standalone flood policies – individual insurance products that provide coverage for a single peril. However, some private firms now offer endorsements to homeowners policies which allow an insured to add flood coverage to their homeowners policy for an additional premium.[1]

Many analysts argue that in order to meaningfully increase flood insurance take-up, coverage would need to be included in homeowners policies. Doing so could benefit consumers, insurers, and communities in several ways.

Potential Benefits

For consumers, this approach would be much simpler and provide the coverages they need in a single policy. It would negate the need for separate flood coverage, including primary, wrap-around, and excess policies. This approach would also ensure that homeowners at risk are insured regardless of any incorrect assumptions they make about their flood risk or whether they are already insured against flood.

For private insurers, this approach would eliminate costly legal disputes related to the NFIP over the cause of damage after hurricanes or tropical storms. Rolling all coverages into a single policy would likely reduce administrative, marketing, and adjustment costs, especially for those firms offering both homeowners and standalone flood. With this approach it may also be relatively simpler for insurers to adjust flood premiums as new information becomes available. For example, an insurer may have to increase the premium on a standalone flood policy by 50% after learning new risk information. However, if flood was part of the homeowners policy, that same increase to the flood premium may only be 10% to 20% of the total premium, which would be much more palatable for consumers and regulators.

Including flood in homeowners policies would increase the number of households that have the financial resources to recover after an event, which also benefits the flood-impacted community and taxpayers across the country. Insurance allows households to recover and return to their everyday lives more quickly. It provides a reliable source of funding so that homeowners don't have to take out loans, draw down savings, or divert other spending. This financial protection allows survivors to continue to participate in the local economy and support local businesses, which they might otherwise be unable to do.

Further, with more homeowners insured against flood, fewer may rely on state or federal disaster assistance. Widespread flood coverage could reduce some of FEMA's spending on Individual Assistance and may cause Congress to appropriate fewer funds to HUD's CDBG-DR program. This approach may also reduce the NFIP's insurance activities including investments in flood risk communication and marketing and administration of flood insurance (via WYO firms).

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[1] The private residential flood insurance market is quite small relative to the NFIP. We estimate that private flood insurance accounts for roughly 3.5 to 4.5 percent of all primary residential flood policies currently purchased. See [The Emerging Private Residential Flood Insurance Market in the United States.]

This would allow the program to focus more energy and resources on flood mapping, floodplain management, and hazard mitigation.

Prospects and Concerns

For this approach to significantly increase flood insurance take-up, the largest U.S. homeowners insurers would need to participate. However, these firms are hesitant to enter the flood insurance market and have a number of concerns. Chief among is their ability to charge risk-based rates. Insurers are concerned that state regulatory practices may limit their ability to adjust rates or policy coverages as they gain experience in writing flood. They are also concerned about the concentration of risk in their portfolio and the correlation of flood with existing wind exposure. Finally, they are concerned that as they explore the market, the need to raise premiums or scale back coverage may have a negative impact on their reputation and business.

Despite these concerns, a few major insurers have entered the private residential flood market through subsidiaries. For example, a subsidiary of one major firm offers a flood endorsement for X-zone homes in Colorado and that of another offers an endorsement on A- and X-zone homes in Florida. Another insurer offers a flood endorsement targeted at high value X-zone homes in 48 states.

Flood endorsements are offered mainly by admitted insurers – those whose rates and forms are subject to state regulation. 18 of the 26 admitted insurers we identified currently offer flood endorsements. Among these, only one matches flood coverage with the homeowners policy; several provide flood coverage that exceeds NFIP limits, and a few match NFIP limits. Most provide coverage outside the SFHA only, though some will write in the A zone. Few will write in the V zone. Two programs offer low-limit flood endorsements – up to $50,000 of coverage – for X-zone properties.

Among the approximately 200,000 private flood policies currently in-force throughout the U.S., at least 50,000 are endorsements to homeowners policies.

Discussion Questions:

- What impact would the inclusion of flood coverage in homeowners policies have on take-up rates in and out of the SFHA?
- Would this cause large price increases for homeowners coverage in some areas?
- What policies would make large homeowners companies comfortable including flood?
- States require auto liability insurance and mortgage lenders require homeowners insurance. Why don't either of these actors require homeowners to carry flood or earthquake insurance?
- Why are state regulators specifically, reluctant to require flood in homeowners? Is it concern that premiums may be "too high"? Or is the central issue insurers' unwillingness to offer flood coverage in homeowners policies?