FEMA is transforming the National Flood Insurance Program (NFIP) to improve the policyholder experience and better reflect industry best practices. A central component to this transformation is a new Risk Rating 2.0 effort, which will improve how the NFIP determines flood risk and flood insurance premiums.

Risk Rating 2.0 will help customers better understand their flood risk and provide them with more accurate rates based on their unique risk. This will include determining a customer's flood risk by incorporating multiple, logical rating variables–like different types of flood, the distance a building is from the coast or another water source, or the cost to rebuild a home. The new rating plan will also aim to ensure customers will no longer face dramatic rate increases during map changes or at the edge of flood zones. By reflecting the cost to rebuild, the new rating plan will also aim to deliver more equitable rates for owners of lower-value homes. By leveraging industry best practices and technology, FEMA plans to reduce the complexity of buying flood insurance, so that it is as straight-forward as homeowner's and auto insurance for both agents and applicants.

The new rates for all single-family homes will go into effect nationwide on October 1, 2020. We look forward to sharing more information in the coming months as information becomes available.

FEMA Unveils 'Risk Rating 2.0'

BY WYATT STEWART

On Monday, FEMA announced changes to the way the NFIP will charge homeowners for flood risks. The change—dubbed "Risk Rating 2.0"—could have a significant impact on flood insurance bills for millions of Americans.

The changes could lead to higher flood insurance rates for some homeowners and lower rates for others. FEMA believes that "Risk Rating 2.0" will enable it to use new data to more accurately price flood risk for NFIP policies. Instead of primarily focusing on whether a property is in a 100-year flood plain, FEMA will now use data based on an individual property's flood risk and rebuilding cost to price NFIP policies.

As the NFIP moves forward with "Risk Rating 2.0" and rates better reflect the gradation of risk within a flood zone, the Big "I" is hopeful that the result will be more transparent and accurate flood insurance pricing. The Big "I" is also hopeful that "Risk Rating 2.0" will eventually yield better risk communication for consumers, driving an increase in flood insurance take-up rates.

FEMA plans to announce the new flood insurance rates for single-family homes April 1, 2020, and said the rates will take effect Oct. 1, 2020.

The NFIP is currently scheduled to expire on May 31 of this year. "Risk Rating 2.0" could become part of the conversation in efforts to reauthorize the program on a long-term basis.

The National Flood Insurance Program is launching a new risk rating system for its flood insurance policies.

David Maurstad, deputy associate administrator of the Federal Insurance and Mitigation Administration and chief executive of the NFIP, called Risk Rating 2.0 a “game-changing initiative for the NFIP” during a media call on Monday.

“Most people don’t understand their risk,” he said. “If you look at the flooding in Nashville and my home state of Nebraska that is going on right now, unfortunately most people in those areas don’t have flood insurance. If we have a better product and people understand what their risk is, we will have more insured survivors, and that means less disaster suffering.”

More information about policyholder impacts and the implementation timeline will be released in the coming weeks, but the new rating system for flood risks will be “data-driven” and factor in different variables rather than basing flood insurance premiums simply on whether or not a policyholder is in a flood zone, Mr. Maurstad said. For example, the new system will determine a policyholder’s flood risk by incorporating elements such different types of flooding — heavy rainfall from a hurricane, river overflow or coastal surge — and a building’s distance to a coast or river.

“We’re going to change an insurance rating structure that hasn’t fundamentally been changed since the 1970s,” he said. “We’re going to consider more flood risks than we currently do now. It is going to be based on replacement costs of the properties.”

The intention is to try to “close the insurance gap,” Mr. Maurstad said.

“Just changing the rating doesn’t guarantee that we’re going to have more policyholders,” he said. “My belief is that with the changes that we’re making in Risk Rating 2.0 of actually showing the rate based on site-specific conditions, that that will create greater demand for our product as people get a better understanding of what their real flood risk is. I think the current in or out, required or not required based on whether you have a federally backed mortgage — that discussion is going to, I believe, change as this new risk rating goes into play and people even outside the high-risk areas will have a better understanding of what their specific risk is. Once we create that demand or they understand their need for it, they will take the responsible action and insure for flood just like they insure for windstorm, hail and fire.”

Some rates will increase while others will decrease, Mr. Maurstad said. “We don’t know what that looks like at this point in time,” he said. “We will as this gets more fully developed. But most importantly, we’re going to have a new rating structure that is fair, easier to understand and articulates to folks what their true risk is.”

But the new rating system will not address the issue of repetitively flooded properties specifically, as current NFIP authority does not require or facilitate additional charges for these properties. Addressing the multiloss properties issue will likely continue to be a discussion point with reauthorization of the program, according to the Federal Emergency Management Agency.

While these properties comprise just 1% of the claims filed through the NFIP, they have historically accounted for between 25% and 30% of the program’s losses, according to research by the Pew Charitable Trusts in Washington.

Flood insurance premiums could rise and property values fall in the most deluge-prone areas under a plan the Trump administration intends to roll out in coming weeks to change the way risk is calculated under the National Flood Insurance Program. Instead of simply focusing on whether a home is inside or outside of the 100-year flood plain, the Federal Emergency Management Agency plans to use private-sector data to calculate the real flood threat for each home and set costs based on that data, according to people familiar with the effort and a briefing document obtained by Bloomberg.

Samantha Medlock, North America head of capital, science and policy at insurance broker Willis Towers Watson Plc, said the change "could be the first major advancement to improve understanding of flood risk since the creation of the NFIP itself." The change could also hurt communities with the greatest flood risk. The new policy "is certainly an issue of concern and one we are actively tracking and engaged on," Liz Thompson, spokeswoman for the National Association of Home Builders, said in an email.

The overwhelming majority of American households with flood coverage receive their policies through the National Flood Insurance Program, which covered about 5 million policyholders in 2017. Despite the growing risk of flooding due to climate change, the number of policies under the program has fallen about 10 percent from its peak in 2009.

Flood insurance will get fresh attention this week from Congress. On Wednesday, the House Committee on Financial Services is set to hold a hearing on reauthorizing the NFIP. Lawmakers have struggled to reform the program. In 2012, Congress passed changes that would impose premiums that reflected the full risk for homes, only to back down two years later in the face of intense public opposition.

FEMA, asked to comment on its plans, offered a statement by David Maurstad, deputy associate administrator for insurance and mitigation, who said the new system "will help customers better understand their flood risk and provide them with more accurate rates based on their unique risk."

The initiative, which FEMA calls Risk Rating 2.0, comes as climate change places growing pressure on the publicly subsidized flood insurance program. Claims often outpace premiums, saddling the program with a debt that topped $30 billion in 2017. The models that determine those rates ignore certain kinds of flooding, such as intense rainfall. And many Americans at risk of flooding nonetheless don't buy insurance.

Transparent Costs

The new system is designed to address some of those problems. The agency plans to pair its existing mapping data with "commercial catastrophe models," as well as the "geographic and structural characteristics" of the home, according to a briefing document presented by FEMA to private flood insurance representatives in October and obtained by Bloomberg.

The goal, according to that document, is more transparent and understandable costs, which will in turn spur more people to get flood protection. "Policies that are easier to sell and buy = more insurance coverage," the document says. The document offers the example of two homes in a 100-year flood plain. The first home, at the edge of that zone, faces low risk of flooding from inland flooding or storm surge; the second faces higher risk from both. Under the current system, each home pays the same premium; with the changes, the first home's premiums would fall by 57 percent, while premiums for the second home would more than double.

Customer Risk

The same document, dated Oct. 17 2018, said that FEMA would first introduce the new risk rating system for states along the Gulf Coast and Southern Atlantic, from Texas to North Carolina. New rates would begin to take effect in 2020.

A FEMA spokeswoman said parts of the document were no longer accurate, but declined to say which ones. “Our new system will determine a customer’s flood risk by incorporating multiple, logical rating variables –- like different types of flood, the distance a building is from the coast or another water source, or the cost to rebuild a home,” Maurstad said.

The agency said it didn’t yet know what the effect of the new system would be on premiums. But rates are likely to go up in neighborhoods with the greatest exposure to flood risks, which could hurt property values in those areas, according to Michael Berman, a former chairman of the Mortgage Bankers Association who worked on housing issues for the Obama administration and has been briefed on the plan.

Important Initiative

Still, Berman said the initiative was an important one. “Anything that they can do to improve people’s understanding of flood risk compared to binary 100-year flood plain is good for consumers and good for investors in the long run, even if it raises premiums,” he said.

Increasing the cost of flood insurance tends to depress home values for two reasons, according to Asaf Bernstein, an economist at the University of Colorado at Boulder whose research includes asset pricing and household finance. Not only do higher premiums raise the cost of owning a home; they also act as a warning to potential buyers about the likelihood that a house will flood.

R. J. Lehmann, director of insurance policy at the R Street Institute, which advocates for market-based solutions to climate change, said that even if FEMA’s new approach caused home values to fall in some areas, the shift was necessary.

Updated Look

“Adapting to climate change is never going to be a cost-free exercise,” Lehmann said in a phone interview. “We absolutely need a more granular and more updated look at what flood risk is.”

A spokesman for the National Association of Realtors, Wesley Shaw, declined to comment on what the change could mean for homes values in areas with the greatest flood risk.

“We need to wait and see what FEMA comes out with before we can evaluate the market impact,” Shaw said by email. “We welcome FEMA’s efforts to modernize and improve the fairness of its ratings methods.”

FEMA said the way the law is written on flood insurance gives it the authority to change the way it sets rates without action from Congress. The agency said it hadn’t yet decided when the new rates would take effect, and how quickly.

“We will take an agile approach to share information transparently about the release of this new system with all stakeholders,” Maurstad said.