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Learning from the Past, Thinking About the Future—Federal Insurance Programs

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Outline

- General Thoughts
  - Why use an insurance mechanism?
  - Government tools
- Specific Programs
  - Terrorism Risk Insurance Act (2002)
  - National Flood Insurance Program (1968)
  - Federal Crop Insurance Program (1938)
- Lessons Learned?

Why Use an Insurance Mechanism?

- Pre-fund disaster costs
- Share disaster costs with program users or private sector
- Internalize risk and promote mitigation
- Use preexisting channels to more quickly provide post-disaster assistance

Addressing Insurance Market Issues

- Regulate
  - E.g., mandatory offer provisions or rate regulation
  - Mandatory consumer purchase

- Subsidize
  - Provided to consumer or insurer or both?

- Directly provide insurance
  - Continued private sector involvement?

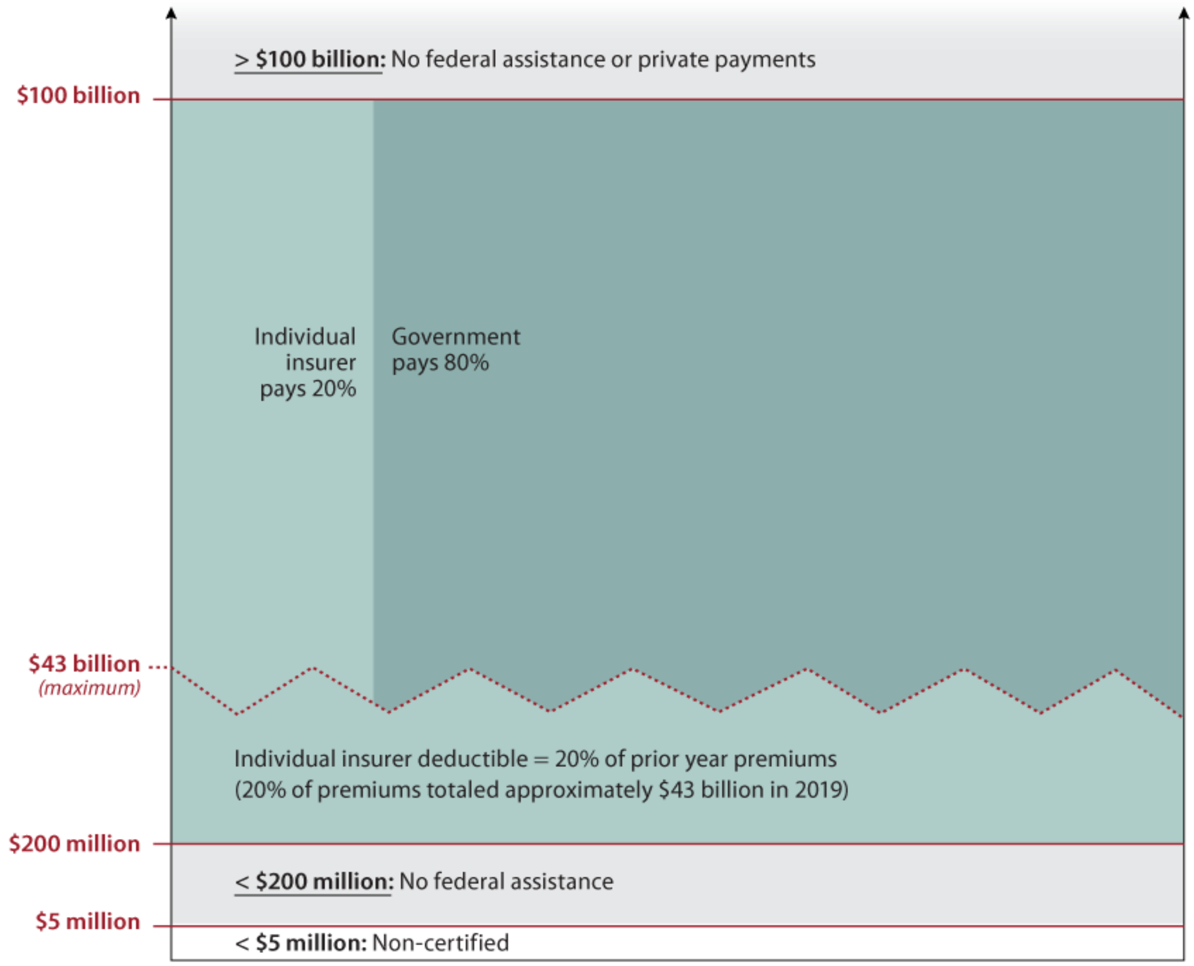
Terrorism Risk Insurance Act (TRIA)

- Post-September 2001 attacks, insurers begin excluding terrorism coverage
- Potential economic slowdown feared
  - Especially large city construction
- Congress responds with TRIA in November 2002

How TRIA Works

- Government-provided reinsurance
  - Risk sharing with primary insurers
- Relatively little federal regulation
  - Mandatory insurer participation and offer
  - No mandatory purchase
  - Policy forms and rates under state regulation
- Indirect subsidization
  - No premiums paid
  - After the fact recoupment

TRIA Loss Sharing



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National Flood Insurance Program

- Private insurers withdraw flood coverage in the 1950s and 60s
- Congress responds with the National Flood Insurance Act
- Private insurers recently have begun to write more flood insurance
- NFIP still the dominant flood insurer in the United States

How the NFIP Works

- Government-provided primary insurance
  - Private insurers play significant administrative role, but bear no risk
  - Government determines policy forms and rates
  - NFIP purchases private reinsurance

- Partial mandatory purchase
  - Through the mortgage system

- Significant subsidies
  - Cross subsidization within NFIP
  - Treasury line of credit

Federal Crop Insurance Program

- Federal crop insurance dates to the Great Depression
  - Private sector abandoned attempts to provide comprehensive loss coverage prior to 1930s
  - Federal crop insurance has always coexisted in the marketplace with private sector products that provide less comprehensive loss coverage (e.g., crop hail insurance)

- Integral part of government support system for agriculture

- Policies cover the vast majority of U.S. crop acreage

How FCIP Works

- Government-provided reinsurance
  - Risk sharing by primary insurers
  - Annual appropriation ($1.4 billion average)
- Substantial federal regulation
  - Policy forms and rates
  - Mandatory offer
- Direct federal subsidization
  - Farmer purchases: annual appropriations ($ 7-8 billion average)
  - Insurer delivery costs: annual appropriations ($1.5 billion average)

Lessons

- Public-private partnership?
  - Government is unparalleled as a capital source
  - May not have insurance expertise
  - Private sector incentives often misaligned with social purpose

- Will people buy the insurance?
  - TRIA take-up rates vary across geography and business size
  - 5 million NFIP policies, but how many houses are there in the United States?
  - Low uptake of unsubsidized FCIP products historically; current subsidy rates of approximately 2/3 of premium

QUESTIONS?

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