FEMA Expands its Reinsurance Program by Transferring $500 Million in Flood Risk to Capital Markets

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WASHINGTON - The Federal Emergency Management Agency announced today its August 1, 2018 reinsurance placement for the National Flood Insurance Program (NFIP). For the first time, FEMA has secured reinsurance directly backed by capital markets investors, continuing efforts to better manage the program's financial risk.

FEMA enters into a three-year reinsurance agreement, effective August 1, 2018, with Hannover Re (Ireland) Designated Activity Company (DAC), a reinsurance company. Hannover Re acted as a "transformer," transferring $500 million of the NFIP's financial risk to capital markets investors by sponsoring the issuance of a catastrophe bond through a special purpose reinsurer. This placement complements the NFIP's existing traditional reinsurance coverage for calendar year 2018.

"Reinsurance is a lynchpin to help strengthen the financial framework of the NFIP," said David Maurstad, chief executive of the National Flood Insurance Program. "Engaging capital markets was the logical next step in maturing the NFIP Reinsurance Program in a way that benefits policyholders and taxpayers, and expands the role of the private markets in managing flood risk in the United States."

Under the August 2018 reinsurance agreement, Hannover Re will indemnify FEMA for a portion of flood claims that result from a qualifying flood event that occurs between the dates of August 1, 2018 and July 31, 2021. The agreement is structured to cover, for a given flood event, 3.5 percent of losses between $5 billion and $10 billion, and 13 percent of losses between $7.5 billion and $10 billion. FEMA will pay $62 million in premium for the first year of coverage.

Effective January 1, 2017, for a term of one year, FEMA secured $1.042 billion of traditional reinsurance coverage from 25 reinsurance companies. Following Hurricane Harvey, FEMA recovered the full $1.042 billion from its reinsurers. In 2018, FEMA expanded its cornerstone reinsurance placement by 40 percent. Effective January 1, 2018, for a term of one year, FEMA secured $1.46 billion in traditional reinsurance coverage from 28 reinsurance companies to cover any qualifying NFIP flood losses in excess of $4 billion per event.

Combined with the January 2018 traditional reinsurance placement, the August 2018 placement enables FEMA to transfer $1.96 billion of the NFIP's flood risk for the 2018 hurricane season to the private sector. By engaging both the traditional reinsurance markets and the capital markets, the NFIP can reduce risk transfer costs, access greater market capacity, and further diversify its risk transfer partners.

For the August 2018 placement, FEMA contracted with Guy Carpenter and GC Securities, a division of MMC Securities LLC, which is a subsidiary of Marsh & McLennan Companies, to serve as structuring agent and with Aon Benfield for financial advisory services. GC Securities and Aon Securities Inc. served as book runners, marketing the catastrophe bond to capital markets investors. KatRisk LLC, a catastrophe modeler, analyzed NFIP risk for investors.

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