FEMA Advisory – Feb. 25, 2021

FEMA Renews its Reinsurance Program by Transferring $575 Million of Flood Risk to the Capital Markets

FEMA continues to engage reinsurance and capital markets to help strengthen the financial framework of the National Flood Insurance Program (NFIP) and promote private sector participation in flood-risk management.

FEMA entered into the agency's fourth, three-year reinsurance agreement, effective Feb. 23, 2021, with Hannover Re (Ireland) Designated Activity Company (DAC). Hannover Re acted as a "transformer reinsurer," transferring $575 million of the NFIP's financial risk to capital markets investors by sponsoring the issuance of a catastrophe bond through a special purpose reinsurer.

As part of the agreement, FEMA will pay $79.44 million in premium for the first year of reinsurance coverage. The agreement is structured to cover, for a given flood event, 12.5% of losses between $6 billion and $7 billion, and 22.5% of losses between $7 billion and $9 billion.

This placement builds on the existing transfer of the program's flood risk to capital markets investors since 2018. Each placement is a 3-year term:

- $500 million in August 2018
- $300 million in April 2019
- $400 million in February 2020

These capital market placements complement the flood insurance program's existing traditional reinsurance coverage, allowing FEMA to grow the reinsurance program that protect against future flood losses. Combined with the previous three capital market placements and January 2021 traditional reinsurance placement, FEMA has transferred $2.928 billion of the NFIP's flood risk to the private sector ahead of the 2021 hurricane season, with $500 million in coverage expiring in August 2021.

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 reinsurance partners.

With reinsurance, private companies assume a portion of the NFIP's flood-risk exposure from catastrophic flood events in exchange for premium payments. If such an event occurs, the reinsurance companies cover a portion of the NFIP's losses, reducing FEMA's need to borrow from the U.S. Treasury to pay claims. With the reinsurance program in place in 2017, the NFIP recovered $1.042 billion from the private markets due to losses from Hurricane Harvey.

FEMA received authority to secure reinsurance through the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12) and the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA).

FEMA is committed to further developing and maturing the NFIP Reinsurance Program in a manner that helps strengthen the financial framework of the NFIP, is beneficial to policyholders and taxpayers, and expands the role of the private markets in managing U.S. flood risk.

More information will be posted on the NFIP Reinsurance Program webpage at: www.fema.gov/nfip-reinsurance-program.

FREQUENTLY ASKED QUESTIONS

Why is FEMA engaging the capital markets?

FEMA is committed to further developing the NFIP Reinsurance Program in a manner that helps strengthen the financial framework of the NFIP, is beneficial to policyholders and taxpayers, and expands the role of the private reinsurance and capital markets in managing U.S. flood risk.

Expanding the NFIP Reinsurance Program to secure both traditional reinsurance and reinsurance backed by the capital markets responds to congressional direction authorizing FEMA to secure reinsurance for the NFIP “from the private reinsurance and capital markets.”

Additionally, engaging the capital markets has the following benefits:

- The NFIP is able to secure multi-year coverage, which locks in favorable pricing for a longer period of time
- The full amount of transferred risk is safeguarded in a collateralized trust account, which is more secure than relying on a company’s strong credit rating
- The NFIP can access a greater base of possible capital, which also familiarizes more private sector partners with the NFIP
- A wider investor base diversifies the entities assuming NFIP risk, recognizing that markets go through cycles
- Traditional reinsurance markets have different market drivers than capital markets; taking advantage of these differing market drivers should result in greater competition and cost efficiency

What does it mean for reinsurance to be backed by the capital markets?

With reinsurance backed by the capital markets involving insurance-linked securities (ILS) – qualified investors put their money at risk in exchange for interest payments. FEMA’s capital market reinsurance placements involve a particular form of ILS, known as a 144A catastrophe bond.

What is Hannover Re’s role?

FEMA entered into a reinsurance agreement with Hannover Re (Ireland) Designated Activity Company (DAC), a reinsurance company. Hannover Re acted as a "transformer reinsurer," transferring a portion of NFIP's financial risk to eligible investors in capital markets by sponsoring issuance of a catastrophe bond through a special purpose reinsurer.

What is a Special Purpose Reinsurer?

To transfer the NFIP's flood risk to capital markets investors, Hannover Re (Ireland) DAC established a special purpose reinsurer (SPR), FloodSmart Re Ltd. in Bermuda that exists for the sole purpose of issuing the catastrophe bonds to investors and carrying out the SPR's obligations to Hannover Re and investors under a retrocession agreement.

It is standard industry practice for entities such as Hannover Re to establish SPRs to comply with financial regulation and facilitate the economics around catastrophe bonds. For FEMA, Hannover Re's use of an SPR enhances the security of the collateral underlying the NFIP's reinsurance coverage.

Doesn't the TAA preclude FEMA from doing business in Bermuda?

FEMA can only purchase reinsurance from companies based in countries designated under the Trade Agreements Act of 1979 (TAA), such as Ireland, where Hannover Re (Ireland) Designated Activity Company (DAC) is located. However, the TAA does not constrain Hannover Re from conducting its business (including establishing a special purpose reinsurer) in non-TAA-designated countries like Bermuda.

What type of investors qualify to participate in the transaction?

Only Qualified Institutional Buyers (QIBs) and, with respect to U.S. persons, Qualified Purchasers (QPs) in permitted U.S. jurisdictions or permitted non-U.S. jurisdictions can invest in such a 144A catastrophe bond.

The U.S. Securities and Exchange Commission's regulations define QIBs as certain "entities, acting for its own account or the accounts of other qualified institutional buyers that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity." 17 CFR 230.144A. A QP is a person with not less than $5 million in investments; a company with not less than $5 million owned by close family members; a trust with not less than $5 million; an investment manager with not less than $25 million in assets under management; or a company with not less than $25 million. Investment Company Act of 1940, Section 2(a)(51).

Can investors in the capital markets trade the 144A catastrophe bond backing the NFIP's reinsurance coverage?

The four NFIP capital reinsurance placements between August 2018 and February involve a particular form of insurance-linked security (ILS), known as a 144A catastrophe bond. The initial investors in the bond can trade on the secondary market to other Qualified Institutional Buyers (QIBs) and, with respect to U.S. persons, Qualified Purchasers (QPs) in permitted U.S. jurisdictions or permitted non-U.S. jurisdictions. Because the proceeds from the original sale of the catastrophe bond were placed in a U.S.-based reinsurance trust account with FEMA as the beneficiary, such trading will not impact the NFIP's ability to collect payments under the reinsurance agreement if qualifying flood losses occur.

How does the February 2021 reinsurance placement work with the NFIP's existing traditional and capital markets reinsurance?

Combined with the August 2018, April 2019, February 2020 and February 2021 capital market placements and the January 2021 traditional reinsurance placement, ahead of the 2021 hurricane season, FEMA has transferred $2.928 billion of the NFIP's flood risk to the private sector with $500 million expiring in August 2021.

How much money did FEMA receive from reinsurers as a result of Hurricane Harvey?

FEMA recovered the entire $1.042 billion in calendar year 2017 reinsurance coverage due to losses associated with Hurricane Harvey.

When did FEMA receive funds from reinsurers for Hurricane Harvey?

FEMA sent a proof of loss to its reinsurers on Dec. 5, 2017 and received payments for the entire $1.042 billion in reinsurance coverage by Dec. 15, 2017.

Why was FEMA able to upsize its placement above prior reinsurance placements?

FEMA, as a repeat user of catastrophe bond reinsurance, was able to increase its capacity from prior years, and lower the economic costs of such protection because of favorable market conditions and strong interest from worldwide capital markets investors based on market familiarity with National Flood Insurance Program risk.

Contact Us

If you have any questions, please contact FEMA Office of External Affairs:

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