LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

Wednesday, April 21, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Cleaver, Green, Clay, Ellison, Driehaus; Capito, Neugebauer, Marchant, and Jenkins.

Also present: Representatives Taylor, Costello, and Scalise.

Chairwoman WATERS. The Subcommittee on Housing and Community Opportunity will come to order. Thank you very much. I would like to ask the members to take a seat at the table.

We are very pleased to have so many Members of the House with us today. And I would like to start the hearing by getting the statements from the Members. I know that you're all busy, and you don't want to sit through our opening statements.

So, with us today, we have the Honorable Jerry Costello, the Honorable Doris Matsui, the Honorable Steve Scalise, and the Honorable Gene Taylor. And we will start with the Honorable Doris Matsui.

STATEMENT OF THE HONORABLE DORIS O. MATSUI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. MATSUI. Thank you, Madam Chairwoman. I thank the chairwoman, my friend from California, Ms. Waters, and Ranking Member Capito for allowing me to have the opportunity to testify before the subcommittee today, for scheduling consideration of the Flood Insurance Reform Priorities Act tomorrow.

This legislation, which I am pleased to cosponsor, would reform the National Flood Insurance Program, NFIP, and contains language, H.R. 5125, that I authored, which would provide technical changes to Federal flood zone designations.

I would also like to thank Chairman Frank and Ranking Member Bachus for their continued advocacy for H.R. 1525. Both of them and their incredible staffs have been invaluable during this process.

Additionally, I am grateful to FEMA for collaborating with Congress to craft a number of NFIP modifications. From my hometown in Sacramento to the Louisiana Bayou to the plains of the Midwest, communities are improving their flood protection infrastructure in order to keep Americans safe and secure. However, as we work to conform to changing dynamics of Federal standards, these communities are seeking clarity as they work to meet Federal regulations.

Public safety is my absolute number one priority. H.R. 1525, which was approved last summer by the House as part of the National Flood Insurance Program Extension Act, would give communities clarity, so that they can continue to improve flood defenses.

Specifically, this legislation would update current law to take local and State funding into account when determining flood zone designations. Sacramento residents and the State of California have devoted hundreds of millions of dollars toward flood protection. It is crucial that this investment be recognized by the Federal Government. FEMA needs to identify the contributions made by the States and cities when they review the progress made on Federal levees as they determine an area's flood designation.

For example, on one project in my district in the Natomas Basin, by next year, the State and local governments will have spent more than $350 million over the last 5 years on levee improvements, without acknowledgment from FEMA in the remapping process. Protecting our constituents from the dangers of floods requires a comprehensive approach. Local communities, States, and the Federal Government must all be thoughtful and committed partners.

With regard to another issue I would like to raise, I believe that it is equally important to note that since Hurricane Katrina, FEMA has issued new flood insurance rate maps in many parts of this country. In my district, those maps place an area in an AE flood zone, and trigger the Federal requirement to carry flood insurance for more than 15,000 homeowners. There is no doubt that the Natomas Basin, like most of Sacramento, is at risk of flooding, as it lays at the confluence of two major rivers.

But, as I noted earlier, the Sacramento Area Flood Control Agency, SAFCA, is working with the Army Corps of Engineers and the California Department of Water Resources to implement an aggressive and ambitious levee improvement plan to achieve a 200-year level of flood protection.

While these efforts are ongoing, flood insurance has become mandatory, and costs homeowners more than $1,250 annually. This is nearly 4 times the PRP rate. While I always urge homeowners in floodplains to purchase flood insurance, I have serious concerns about families being forced to incur higher insurance rates during an economic recession. Increased rates on top of the annual flood protection assessments that many residents are paying each year compounds this problem.

I am pleased at the legislation to be considered by this committee tomorrow with phased-in rates for newly mapped areas. This provision is a good start, but I would respectfully encourage the committees to work with FEMA to offer reduced flood insurance premiums to those areas that have already been remapped, or implement other policies that would ensure the affordability of flood insurance rates. In doing so, the committee would make sure that responsible homeowners across the country continue paying into the NFIP without adding risk to the floodplain.

Thank you again for letting me address the subcommittee. I look forward to our continuing efforts to improve flood protection. I yield back the balance of my time, and I apologize for my hoarse voice.

[The prepared statement of Representative Matsui can be found on page 50 of the appendix.]

Chairwoman WATERS. Thank you very much, Congresswoman. Mr. Steve Scalise.

STATEMENT OF THE HONORABLE STEVE SCALISE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Mr. SCALISE. Thank you, Chairwoman Waters, Ranking Member Capito, and distinguished members of the subcommittee. I appreciate the opportunity to testify before your subcommittee on H.R. 1264, the Multiple Peril Insurance Act. This bipartisan legislation has 22 cosponsors, and makes critical reforms that are important to the people of South Louisiana.

By adding multiple peril coverage, which includes wind and hail, to the National Flood Insurance Program, homeowners will have greater protection against damage caused by hurricanes and other storms. Adding wind and hail coverage to the NFIP will give the people in my district the peace of mind that their homes, businesses, churches, and schools will be protected in the face of catastrophic storm damage.

I commend Congressman Gene Taylor for his leadership and diligence on this issue. I am proud to join with Congressman Taylor in championing this bill so that no American has to experience what the people of the Gulf Coast went through after Hurricane Katrina.

We in south Louisiana have to live with the threat of these massive hurricanes every year. But we shouldn't have to live without protection from future storms. As this subcommittee well knows, after Hurricane Katrina, many homeowners found themselves stranded with no payments from their insurance companies. Many homeowners were forced to sue their insurance companies in order to recoup any money from their policies. Some insurance companies overbilled the NFIP for flood damage, while denying homeowners on wind damage payments.

After Hurricane Katrina hit, many private insurance companies refused to write any policies that included wind coverage, and 46,000 people were forced into the Louisiana Citizens Property Insurance Corporation, which is the State's high-risk pool, and Louisiana was forced to borrow $1.4 billion in order to reinsure these additional policies.

Dumping policies into State insurers of last resort is not an effective or efficient solution to the need for wind insurance. Thousands of homeowners who purchased both a wind policy and flood insurance found that neither policy wanted to pay, even though they were covered for both. That's because if some storm damage was caused by wind and some caused by flood, it was up to the homeowner, in many cases, to prove whether wind or flood came first.

This added insult to injury for thousands of homeowners who lost everything to the storm, and just wanted to get their homes repaired. Yet many had to take their insurance companies to court, just to enforce these policies they had been paying premiums on for years.

This important legislation takes vital steps to implement lessons learned, and prevent history from repeating itself. Our current system creates an inherent conflict of interest between private insurance companies and the Federal Government over who pays what when both water and wind cause damage. This legislation eliminates that conflict by providing homeowners with the option to purchase one multi-peril policy for both wind and water. No longer will homeowners be forced into State-run wind pools when private insurance companies refuse to write wind coverage.

Adding wind and hail coverage to the NFIP allows us to spread the risk geographically, and in a much more efficient manner. State-run wind pools concentrate the risk, and a large portion of those policies through the State pool could all be affected by the same disaster, thus making it very difficult for State-run pools to build up enough reserves to pay, in the event of a major disaster.

This problem is not limited to the Gulf Coast alone, though. Wind damage is a risk all across the coastal United States, and it is important to note that 55 percent of American citizens live within 50 miles of a coast. Clearly, this is an issue that affects all Americans, not just on the Gulf Coast.

I recognize that some Members may be concerned that this bill puts American taxpayers on the hook for coastal disasters. To the contrary, this legislation is designed to be actuarially sound. According to the Congressional Budget Office, this legislation would pay for itself through the premiums that would be assessed.

Another important component of this bill is the additional loss of use coverage. After Hurricane Katrina, the Federal Government paid out $34 billion in disaster housing assistance alone. Adding loss of use coverage would reduce reliance on the Federal Government for disaster assistance in the face of catastrophic damage. This bill alleviates some of the burden on taxpayers, as opposed to adding to it, by relying on disaster assistance that is often expensive and subject to fraud.

It is time to enact real reform so that homeowners have comprehensive hurricane insurance protection. Enacting reforms to NFIP will allow us to move forward with a 5-year extension and put an end to these short-term extensions that expire when Congress fails to act. Chairwoman Waters' bill is a step in the right direction towards that full 5-year extension. And I look forward to continuing to work towards this goal.

As we approach hurricane season, enacting these reforms and passing a long-term extension becomes more critical every day. The ultimate goal of our region is to build a comprehensive hurricane protection system that allows us to look back at Katrina and say, "Never again."

I appreciate the opportunity to testify before your committee, and I look forward to working with you in the future to achieve this fundamental goal. Thank you, and I yield back.

[The prepared statement of Representative Scalise can be found on page 60 of the appendix.]

Chairwoman WATERS. Thanks. Next we will hear from the Honorable Gene Taylor.

STATEMENT OF THE HONORABLE GENE TAYLOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSISSIPPI

Mr. TAYLOR. Thank you, Madam Chairwoman, for holding this hearing, and thank you for your many visits to the Gulf Coast region to see for yourself why the present situation isn't working and doesn't need to be repeated.

The bill before you that you were so kind to cosponsor would do several things. Number one, it would increase the amount of coverage for those people who either have their homes destroyed, or substantially destroyed in the course of a storm. Something that shocked all of us who lost our homes was just the incredible cost of replacing them. So it increases that value up to $500,000. It increases the value of the contents up to $150,000. Because for all of us, again, it was a shock how much that stuff in your house was worth when you went to replace it.

Most importantly, though, Madam Chairwoman, it does a couple of things. As my colleague from Louisiana pointed out, it would prevent the horrible situation where tens of thousands of homeowners have to sue their insurance company to have a claim paid that should have been paid the day after the storm. In many instances, it took years. And it wasn't just average joes. The president of the United States Senate, Federal judges—if you can say one thing about the insurance companies after Katrina, they screwed everyone equally. But the sad part is that they screwed everyone.

The second thing is, as Steve pointed out, the people who pay these premiums ought to cover the cost for the loss, not the American taxpayer. But after Katrina, we will prove beyond a shadow of a doubt, it was the American taxpayer who paid.

And lastly, in response to this, the insurance companies, although they have opposed this measure, have walked away from this responsibility only to have another level of government assume that responsibility, and that's the State level. Why is the present situation untenable?

Number one is that the present situation has a conflict of interest built in, where we hire the private sector to sell the policy, no problem there. But we hire the private sector to adjust the claim. After Katrina, agents for State Farm, Allstate, Nationwide, etc., walked onto a piece of property where the house was gone, and had to make the decision. Did the wind do it, which means their company pays, or did the water do it, which means the National Flood Insurance pays? Every time they walked on that piece of property, they said the water did it, and the Federal Government has to pay.

As a matter of fact, an attorney for Nationwide, before the Mississippi Supreme Court, when asked point blank if the house was 95 percent destroyed by the wind before the water ever got there, how do you apportion that claim, how much would Nationwide pay, is quoted as saying, “Not one dime.” For those of you who are fiscal conservatives, you know that is not right, and that has to change.

Number two, it has become a governmental function where the States have picked up the liability. And in the case of a typical State—Florida, for example, now has about $436 billion of exposure. The State of Florida has exposure in a State that has a $70 billion general fund budget. So, imagine if they have the 4 storms that occurred in 2004, again, you would simply bankrupt the State. In my home State, $6 billion of exposure, $6 billion general operating budget.

And the private sector is going to come back and say, “Well, the private reinsurance is going to take care of that.” Quite frankly, if you look through that closely, you will find that most of these reinsurance policies come out of Bermuda. And the experience of the people of Mississippi, Louisiana, and Texas, after the last round of storms, was if we can’t get companies in Springfield, Illinois, and Hartford, Connecticut, to pay claims, how on earth do you expect people in Bermuda to pay those claims?

So, the other thing that happens is—again, trying to look at this from the Federal responsibility—we paid that bill last time. When Steve mentioned—when the insurance companies didn’t pay—a typical homeowner’s policy says if your home is lost, if your home is in a way that you can’t live in it, they will pay to put you up, based on the value of that home. Well, when they totally deny your claim, as they did, then the Federal Government has to step in: $7 billion, just for manufactured housing; $15 billion for housing grants; $7 billion of SBA loans; and about $3 billion just for trailers to put people up on a temporary basis that the Nation paid for, that the insurance companies should have paid for.

So, Madam Chairwoman, I’m trying to live by your 5 minutes. You have been down there a number of times. But the fact of the matter is the present situation is unsustainable. The present situation is now where a typical person trying to rebuild in coastal Mississippi faces a bigger insurance premium for his wind coverage than his mortgage. And when you drive around south Mississippi today and see the thousands of driveways where there used to be a house and there is no longer a house, it’s pretty simple. They can’t afford to rebuild, because the insurance is so expensive because of the situation that has occurred since Katrina.

So, I would ask that you give serious consideration to this. I very much appreciate you having this hearing. And with your permission, I have a much longer statement for the record. But I have been trying to live within the 5 minutes allotted, and apparently, I have done just that.

[The prepared statement of Representative Taylor can be found on page 63 of the appendix.]

Chairwoman WATERS. Thank you very much. And I want to thank you for appearing before the subcommittee today. Without objection, your written statements will be made a part of the record. Without objection, it is so ordered.

And I would now like to ask unanimous consent that Representatives Matsui, Scalise, and Taylor—and Representative Costello, if he shows up—be allowed to be considered members of the subcommittee for the duration of the hearing. And please join us at the dais, if you would like. Thank you very much.

Good afternoon, ladies and gentlemen. I would like to thank Ranking Member Capito and the other members of the Committee on Financial Services for joining me for today's hearing on legislative proposals to reform the National Flood Insurance Program.

The Flood Insurance Program provides valuable protection for approximately 5.5 million homeowners. Unfortunately, the lack of a long-term authorization has placed the program at risk. The program has lapsed twice since the beginning of this year, for 2 days in March, and for 18 days in April. These lapses meant that FEMA was not able to write new policies, renew expiring policies, or increase coverage limits.

This also meant that, each day, 1,400 home buyers who wanted to purchase homes located in floodplains were unable to close on their homes. Given the current crisis in the housing market, this instability in the Flood Insurance Program is hampering that market's recovery, and must be addressed.

I am also concerned about the impact of new flood maps on communities. I recently was able to assist homeowners in the Park Mesa Heights area of Los Angeles, who had been mistakenly placed in a flood zone. I am pleased that FEMA acted quickly to correct this mistake. However, there are thousands of homeowners nationwide who now find themselves in floodplains, and subject to mandatory purchase requirements.

The Flood Insurance Reform Priorities Act of 2010 would restore stability to the Flood Insurance Program by reauthorizing the program for 5 years. It would also address the impact of new flood maps by delaying the mandatory purchase requirement for 5 years, then phasing in actuarial rates for another 5 years. The bill also makes other improvements to the program by phasing in actuarial rates for pre-FIRM properties, raising maximum coverage limits, providing notice to renters about contents insurance, and establishing a flood insurance advocate similar to the taxpayer advocate at the Internal Revenue Service.

Today's hearing will also examine H.R. 1264, the Multiple Peril Insurance Act of 2009. This legislation, authored by Mr. Taylor of Mississippi, would allow the Flood Insurance Program to provide optional wind coverage. Following Hurricane Katrina, many insurers refused to pay out claims for wind damage, and instead insisted that the damage was caused by flood, even when there was evidence to the contrary. The gentleman from Mississippi has personal experience with this. By allowing homeowners to buy wind policies, H.R. 1264 would end this abuse of the Flood Insurance Program.

I am eager to hear the testimony of our witnesses today, and I would now like to recognize our subcommittee's ranking member to make her opening statement. Ms. Capito?

Mrs. CAPITO. Thank you, Madam Chairwoman. And thank you for holding this important legislative hearing on the Flood Insurance Reform Priorities Act of 2010, and the Multiple Peril Insurance Act of 2009. I am looking forward to hearing the testimony of our witnesses today, including our colleagues who have brought their perspectives on the various issues related to flood and wind storm risks in their communities, as well as their efforts to protect against those risks faced by many of their constituents at home.

Floods are among the most frequent and costly natural disasters. And in recent years, storms that have caused flooding have been increasing in frequency and severity. Because private insurance against flooding is generally not available, more than 5 million property owners and 20,000 communities participate in the National Flood Insurance Program, NFIP. While the program continues to provide protection and some measure of financial security for many homeowners and businesses, there are many serious challenges to the financial viability in the years ahead that we must address.

I would depart from my written statement and say this is almost like the never-ending story, because we keep extending for months, or a few more months, and here we need to seek a resolution to this.

So, first and foremost, the NFIP carries a debt of more than $18 billion, and has been placed on a list of high-risk government programs by the Government Accountability Office for the past several years. The program continues to subsidize the premiums of more than one million policyholders, charging them significantly less than the full risk rate.

Furthermore, the NFIP does not collect sufficient premiums to build up reserves for unexpected disasters, such as what we experienced during the 2005 hurricanes.

I want to commend the chairwoman for proposing her legislation to advance reforms, many of which I believe are steps in the right direction toward improving the program. While the discussion draft does not address the NFIP's debt, which weighs heavily on the program's financial future, it does propose many good reforms that were included in legislation previously approved by this committee and the House.

H.R. 1264, the Multiple Peril Insurance Act, is intended to provide property owners with an option to purchase an insurance policy from the NFIP that covers both flood and wind storm experts. Unlike flood insurance, industry experts maintain that wind storm insurance is generally available, either from private insurance carriers or State-based residual market insurance pools. But as we have heard from the testimony of both of our congressional colleagues, this has presented huge challenges when trying to make these programs work to the benefit of the many constituents that were influenced.

I am concerned that FEMA may not be prepared to handle this additional responsibility, and that the taxpayers in general could be subjected to greater losses. Perhaps we can find another way to address the issue, or these issues that this measure seeks to address. As I have already stated, the NFIP has an $18 billion deficit, and I do have concern that adding wind storm coverage while it is struggling financially could be a recipe for a fiscal disaster.

I look forward to working with Chairwoman Waters and other members of the committee, and my other colleagues, on this legislative initiative as we begin deliberation on this.

Chairwoman WATERS. Thank you very much. Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. Our colleague, Mr. Costello, has arrived. I will yield my time to him.

Mr. COSTELLO. I thank the chairwoman for recognizing me. Let me apologize. I was supposed to be with the Member panel, but I was chairing an aviation subcommittee down the hall. But I do appreciate the opportunity to address the subcommittee, and ask unanimous consent to place my full statement into the record.

Chairwoman WATERS. Yes, certainly, without objection.

STATEMENT OF THE HONORABLE JERRY F. COSTELLO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. COSTELLO. Madam Chairwoman, for the past year, I have been working closely with a bipartisan working group of 40 Members, and established the Congressional Levee Caucus with Congressman Rodney Alexander, to discuss issues related to the FEMA map modification process. A common theme that ran through every one of our meetings was: one, the local jurisdictions need more time and more accurate information to address the impact of the new flood maps; and two, the burden of mandatory flood insurance for individuals and communities would be too much to bear during this economic downturn.

The bill introduced yesterday by Chairwoman Waters addresses both of those concerns, and builds on legislation that I introduced last year, H.R. 3415. The solution crafted in this legislation will help a broad range of member congressional districts and communities across the country. Under Chairwoman Waters' proposal, new flood insurance rate maps will take effect on schedule, to ensure that communities and homeowners have full information about the risk.

However, the mandatory flood insurance requirements will not take effect for 5 years in newly mapped areas, and mandatory insurance rates will be phased in over the subsequent 5 years.

I strongly support these provisions, as it will provide an incentive for communities to take quick action to fix levees or complete other work to mitigate flood risk. Prior to and during the delay and phase-in of rates, homeowners will be encouraged to voluntarily buy flood insurance and provided information about flood risk, the availability of flood insurance, and the potential consequences of the failure to purchase insurance. To qualify for this delayed and phased-in, local communities must develop a communication and evacuation plan to educate the community about flood risk, which are two provisions I included in our legislation, my bill, H.R. 3415.

Allowing the flood insurance maps to take effect will achieve FEMA's goal of communicating flood risk to the community, and ensuring homeowners will have complete information. With the delay in the onset of mandatory insurance, homeowners will be able to prepare for the high cost of insurance when the new flood maps take effect.

I am an original cosponsor of Chairwoman Waters' bill, and I believe it will achieve the goals that I have stated all along: provide local communities incentives to rebuild their levees; protect homeowners from the high cost of mandatory insurance; and effectively communicate the risk associated with living in a floodplain.

Again, I thank Chairwoman Waters, Chairman Frank, Ranking Member Capito, and Ranking Member Bachus, and the staff of the Financial Services Committee for working with me on these important issues. And I look forward to seeing the legislation marked up and brought to the Floor for passage.

I thank the Chair for giving me this time, and I look forward to continuing to work with you on these important issues.

[The prepared statement of Representative Costello can be found on page 43 of the appendix.]

Chairwoman WATERS. Are there any other opening statements from this side of the aisle, Ms. Capito? If not, we will move toward having our second panel make their presentations: the Honorable Craig Fugate, Administrator, Federal Emergency Management Agency; and Ms. Orice Williams Brown, Director, Financial Markets and Community Investment, U.S. Government Accountability Office.

I am pleased to welcome our second panel. And without objection, your written statements will be made a part of the record. You will now be recognized for a 5-minute summary of your testimony. Mr. Fugate?

STATEMENT OF THE HONORABLE CRAIG FUGATE, ADMINISTRATOR, FEDERAL EMERGENCY MANAGEMENT AGENCY, DEPARTMENT OF HOMELAND SECURITY

Mr. FUGATE. Thank you, Madam Chairwoman, Ranking Member Capito, and distinguished members of the subcommittee. I am pleased to be here today to discuss reauthorization of the National Flood Insurance Program. Since I have been at FEMA for the last 11 months, I think one of our great challenges, as you pointed out, is the short-term reauthorizations and the gaps that occur, and the impacts, as people try to buy homes and provide insurance for their purchases.

It is important that we understand what the original intent of the Flood Insurance Program was. It's to protect communities against flood. It's to provide affordable flood insurance. And it's to reduce the financial burden on the Federal Government in providing that.

That program is pretty straightforward, but the implementation is quite difficult. And as the discussion goes in many of my conversations with the Members here, as well as your colleagues in the Senate, we do not have a lot of flexibility to address unique challenges as we move forward. And so, we appreciate the work being done in looking at what kind of flexibility could be provided to FEMA, and trying to address some of these needs.

But it comes with a cost. As was pointed out, we have an existing debt over $18 billion. But I also think it's important to talk about what the potential exposure is. Recently, the Miami Herald ran an article about what would happen if a major hurricane hit south Florida, and what kind of exposure would occur, just from flood damages and storm surge. In a major category 5 hurricane, it would be up in the almost $60 billion range. But what was really disturbing was, even in a category 1 hurricane, over $20 billion worth of damage would be flood-related. There are not $20 billion worth of flood insurance policies in effect in south Florida.

So, again, the potential loss, versus what the program has insured, does not always match up. But it does illustrate the large exposure with the Flood Insurance Program against these events.

This also goes back to the mandatory purchasing, in that the only people who are required to buy flood insurance are those at the highest risk—within a 1 percent or greater risk of a flood. We know that over 40 percent of the flood damages occur outside of that, yet less than 1 percent of those homeowners have flood insurance.

So, you're trying to maintain a program to protect homeowners and provide a reasonable cost for this program, yet the only requirement to purchase it is at the highest risk. It would be as, again, a pre-existing condition is the only people who are required to be in this program, yet we're trying to be actuarially sound. It creates a lot of challenges as we go forward, and we continue to map.

The steps we can take to ease this burden, I think, are again, as we do new maps and we do change rate designations, I think it's important we look at existing homeowners and provide graduating scale for increases. I very much support giving us the flexibility to recognize that when levees are being improved but did not require or involve Federal dollars, that we give them the same recognition as we do as those with Federal dollars, and then recognize that work should defer and provide extended periods for implementing any changes. There shouldn't be a distinction between Federal and local and State dollars if the work is being done to protect the community, and we very much support that.

We know that there will be many challenges as we go forward, and we continue to pledge to work with the committee on all the policy recommendations from FEMA. But our challenges are daunting. As was pointed out, about 25 percent of the policies in effect are below actuarially sound rates, which means that we are not collecting enough money to cover that exposure. We have the existing balance of about $18.8 billion we owe, which we do not have any real ability to pay down. We currently pay about $100 million in interest back to the Treasury.

So, we have that debt, plus the exposure, plus the fact that we have policies that are actuarially below what the cost would be to service those policies.

And again, we're reminded that this program is necessary to protect homeowners and protect their mortgages. And when there are lapses in the programs, we literally stop home sales in these areas.

We, again, support a longer extension. We continue to work on this. Americans depend upon this program. Where we have good flood insurance programs, and people do participate, it does reduce the cost to the taxpayer. We look forward to working with this subcommittee and Congress as we go forward, and I will be happy to answer any questions that the committee may have, Madam Chairwoman.

[The prepared statement of Administrator Fugate can be found on page 119 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Brown?

STATEMENT OF ORICE WILLIAMS BROWN, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. BROWN. Good afternoon, Madam Chairwoman, Ranking Member Capito, and members of the subcommittee. I appreciate the opportunity to participate in today's conversation concerning the condition of the National Flood Insurance Program, and options to reform it.

As you know, GAO placed NFIP on its high-risk list in March 2006, after the 2005 hurricane season exposed the potential magnitude of long-standing structural issues on the financial solvency of the program, and brought to the forefront a variety of operational and management challenges. FEMA continues to owe the U.S. Treasury $18.8 billion in losses and interest expenses, which it is unlikely to be able to repay under the program's current design.

My statement today is based on GAO's past and ongoing work, and focuses on NFIP's financial condition, its operational and management challenges, and possible actions that could be taken to address them.

While the structural issues were well known, the management challenges have become more evident in the past several years. We have made recommendations addressing virtually every aspect of the program.

For example, we have recommended that FEMA take action to improve NFIP's management of data quality, the rate setting process, oversight of the insurers that sell flood insurance, the expense reimbursement process, its contractor oversight, and its claims processes. While preliminary results of our ongoing review of FEMA's management reveal that many of these problems are ongoing, for the first time we are encouraged by FEMA's new tone, beginning with its acknowledgment that it faces a number of challenges and is willing to engage in a dialogue with GAO about them.

While acknowledgment of a problem is an important first step, we also expect to see FEMA take actions necessary to meaningfully address these challenges. We are currently engaged in a comprehensive review of NFIP that builds on our past work, and plan to issue a report later this year. We hope that this report will provide a road map for identifying root causes and addressing many of these outstanding issues.

However, we also recognize that many of the challenges facing the program will require congressional action. Moreover, we understand that this is no small issue, given the complexities of the program and the often competing public policy goals, including having rates accurately reflect risk, encouraging participation, and limiting costs to the taxpayer.

For example, many premium rates for properties are subsidized by law, and rate increases are capped for a number of reasons, including offsetting the cost of catastrophe relief. These decisions involve trade-offs that have to be balanced with the goals of NFIP. Specifically, while mitigation is viewed as vital to limiting the government's exposure, charging rates that do not reflect risk may hamper mitigation efforts by encouraging property owners to build in harm's way, and not adequately mitigating.

Moreover, the current NFIP structure increases the likelihood that the program will have to borrow from Treasury when losses exceed premiums collected, thereby exposing the taxpayer to greater financial risk.

Part of this conversation must include a dialogue about the appropriate role of government in paying for losses for natural catastrophes, which, in 90 percent of the cases, include flooding. The other part deals with who should pay for the losses. That is, Congress must decide how much of the cost associated with flooding the government should pay, versus property owners.

In closing, I would like to note that while the $18.8 billion that NFIP owes Treasury may not seem large by today's standards, it is significant compared to NFIP's annual premium revenue, which was $3.2 billion as of February. This debt may also continue to grow unless Congress and FEMA take action to begin to address some of the program's operational and structural issues.

Finally, one option to maintain subsidies but improve the financial stability of NFIP would be to rate all policies at the full risk rate, and to appropriate the subsidized amount to the program. This structural change would remove the financial burden on NFIP by making the subsidy explicit, and make the actual flood risk more transparent to the property owner.

Thank you. And I am prepared to answer any questions that you may have.

[The prepared statement of Ms. Williams Brown can be found on page 74 of the appendix.]

Chairwoman WATERS. Thank you very much. I will recognize myself for 5 minutes.

The map modernization process has caused a lot of concerns for Members and the communities they represent. What kinds of outreach is FEMA doing to communities to make them aware of this process, and to alert them to the possibility of mandatory purchase of flood insurance?

Mr. FUGATE. Madam Chairwoman, the process is, when we go to begin map modernization, we work with the community and begin the work of preliminary data, preliminary map findings. There is an appeal process.

But one of the things that has been pointed out to me by various members at times is the communication with the public has not always been as strong, particularly when we're looking at what would be considered for many people in the public an adverse finding, in that we increase the area in the special high risk which would require mandatory purchasing.

So, again, as we go through this process, there are numerous steps to go through for communities to appeal. But we know that we have to continue to work on the outreach, and communicate to the public what these potential changes may mean, as far as mandatory requirements.

As you point out, about 60 percent of the mapping is done. About 80 percent of the total maps are in a point where we will be accomplishing that in the next fiscal year. And about 20 percent remains to be done. Just off the top, about 7 percent of the new maps increase the risk of designation for high risk. About 1 percent drop out.

And so, again, it's that communication, where 7 percent of the findings may increase the risk, that communication early, and explaining to people why it's important to have flood insurance, particularly as those changes occur.

Chairwoman WATERS. Can you explain to me the role that cities and counties play in this remapping? When we had the problem in Los Angeles, we discovered that there had been some notification to the City—they had done nothing—and that there was old mapping that had been done in cooperation with the county that you were still using as a basis for your information. How does that all work?

Mr. FUGATE. It works based upon each city, each county is individual, as we try to work and identify who is the authority within that community responsible for mapping. Sometimes it's in public works, sometimes it's in community planning.

And again, as you found out in that situation, we had overlapping mapping being done, but not necessarily by the jurisdiction we initially talked to.

So, again, what we have found is we have to do multiple outreach, and try to understand how mapping is being done, how it's going to be implemented, and the jurisdictions that would have authority, whether it be a city, a county, or, in some cases, a water management district, or other flood control boards, such as a levee board or levee authority that may have some piece of that we have to work with.

Chairwoman WATERS. Thank you very much. Ms. Brown, in your testimony, you note that severe repetitive loss properties make up 1 percent of all flood insurance policies, but are responsible for up to 30 percent of all claims. What action should FEMA take to reduce the claim rates of these properties?

Ms. BROWN. GAO has looked at this issue over the years, and we believe that many of the current actions need to be ongoing. And there are also some structural changes that need to be made around definition.

There are many challenges, in terms of forcing these particular homeowners to mitigate the properties. And there is also a dialogue that needs to take place between the program and local officials. We believe this is an area where a common definition would be helpful, in terms of defining what a significant event is, and when the particular issue of a repetitive loss is triggered, and what actions homeowners would have to take.

We found examples where homeowners were able to ignore letters from FEMA and the NFIP involving losses on their property. And by not responding to an offer involving mitigation, they were able to avoid being forced to take any type of action.

Chairwoman WATERS. I see. Thank you very much. Ms. Capito?

Mrs. CAPITO. Thank you. I would like to ask the Administrator, in your comments, and also in Ms. Brown's comments, you both said that the rates that are being charged to the NFIP do not reflect the risk, and they're underpriced. What kind of action items do you have to solve this issue at the present time?

Mr. FUGATE. Not many. Part of our challenge with the Flood Insurance Program is how it's structured, and how we were required to provide insurance, and the rates we're allowed to charge. And that does—

Mrs. CAPITO. Is that statutory?

Mr. FUGATE. It's both statutory and rule. And—

Mrs. CAPITO. And—oh, rule, okay.

Mr. FUGATE. And again, what we have found ourselves facing is, in trying to phase in or do some of the things that are actually being recommended, we would continue to subsidize that risk, and that risk may actually grow.

I think it's the intention of how do we minimize impact to existing homes, and phase in improvements or buy-outs, but deal with new construction. And so, this is a kind of a bind for us, in trying to minimize the fiscal impact to homeowners to have to buy flood insurance, but charge a rate that is sound enough to be able to keep the program whole.

When you bring in, basically, $3.2 billion a year, as long as you don't have any floods, you're doing well. But one or two large-scale flood events far exceed the carrying capacity of that program. And so, again, with those that are subsidized—and that may be a good decision to be subsidized, but it's being subsidized at the rate paid, not at the overall program level.

And so, one of the recommendations of the Government Accountability Office is to have that specifically authorized by Congress, and to pay that differential so that we can at least maintain where we're at with our current exposure, and begin to start paying down some of our—

Mrs. CAPITO. So would that require a further appropriation to be able to subsidize? Is that—

Mr. FUGATE. It would, but it would then allow us to start paying back down some of our debt. As we are structured right now, we really cannot pay down the $18.8 billion. We have no real prospects of paying it down. And, as was pointed out, any time we have flood disasters that exceed our intake for the annual premiums, that number grows. And our interest payments then back to the Treasury grow, because we're not structured to actually adjust our rates high enough to take that into account.

Mrs. CAPITO. So the reason that you can't price for risk is because statutorily and through rule, you don't feel that you have the ability to do that? Is it a combination of—that the policy purchaser can't afford that? Is it all of the above?

Mr. FUGATE. I believe it's all of the above. I will ask my staff, and I will get you a detailed report back on why these are subsidized, and how it's done. But again, if you listen to the questions that we get asked a lot of times, if we find that the risk has increased, we will challenge the maps. But if there is no challenge to the map, then we look at what is the impact to homeowners who now have, as pointed out, escrow billing of up to $100 a month, $1,200 a year that they weren't expecting, and how do we phase that in?

Well, that, in turn, will subsidize that risk until, at some point, we either have a rate being charged that is actually based, and we phase that in over 5 years—but in that phase-in, it's under the risk that the exposure is being paid for.

Mrs. CAPITO. Well then, if we're going to, under the multi-peril bill, which would add wind as a peril under the NFIP, do you anticipate that you would be able to adequately price that for the risk? And can this program sustain another large—what I would anticipate could be large; we really don't know, I don't think—added burden without further appropriation?

Mr. FUGATE. It is a key concern to us. And in meeting with Congressman Taylor, we have discussed this issue.

I, coming from Florida, recognize very clearly some of the challenges we have when we have perils that are written separately, and then trying to figure out how to adjudicate who pays. But that issue of how do we maintain and be able to run this program, and make it actuarially sound is a question we don't have a comfort with yet.

Mrs. CAPITO. Well, one of the concerns you just mentioned, that it would take further appropriations to reach the proper subsidies to be able to get the rates to match the risk, or for you to pour down—to pay down the debt that you have to the Treasury. But basically, you would just be taking from the Treasury to pay down the debt to the Treasury. That has a kind of false ring to it, I think, in my mind.

And I guess, to me, adding another peril—while I understand the gentleman—we kind of went back and forth on this on the Floor of the House with Mr. Taylor and I when this was on the Floor the other day—or last year. I understand this, but I do have concerns of the long-term viability of the NFIP to be able to take on this added burden at a time when you're really falling behind daily, as—if what I'm hearing from both of you is the correct analysis.

And with that, I will yield back the time that I do not have any longer.

[laughter]

Chairwoman WATERS. Thank you very much. Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman. I have a few questions for the record. The first question is, is it true that when we have flood damage, we also sometimes will have wind damage? I know the answer is yes, but I would just like to have you—

Mr. FUGATE. Absolutely.

Mr. GREEN. And is it true that an insurance company will send out an agent to assess the damages?

Mr. FUGATE. That is true.

Mr. GREEN. And is it true that this agent will literally be employed by the insurance company, not the Federal Government?

Mr. FUGATE. That is true.

Mr. GREEN. And employed by the insurance company for edification purposes—I know that everybody knows this—but it means that this person receives an emolument from the insurance company, something that we commonly call a paycheck. True?

Mr. FUGATE. That is true.

Mr. GREEN. And receiving this paycheck from the insurance company in no way influences the judgment of this person who comes out to assess the damages. Is this true?

Mr. FUGATE. That is the intention of the program.

Mr. GREEN. I understand the intention of the program. And, believe me, I understand that was a difficult question. I understand.

But the point that I would like to get to is this: We have something known as de facto subsidies. De facto subsidies, with reference to this circumstance, occur when the insurance company is in the unique position of deciding whether it should pay, or deciding whether the government should pay. And, in so doing, every time the insurance company can roll the dice and get the government to pay, it gets a subsidy—not a subsidy in law, but a subsidy in fact.

So, there is really an inducement for insurance companies to want to have wind coverage in areas where you are going to have flood damages, where you're going to have hurricanes. Because, when they can get that coverage—if the system remains as it is—there is a possibility that they will have a chance to roll the dice and make a decision as to whether it is going to be flood or it is going to be wind.

You don't have to agree with that, but my point to you is this. If we do not change that system, is it possible that the Federal Government is subsidizing some insurance companies by way of allowing the agent to determine the damages? Not in every case, not in any percentage of cases. But in some cases, the insurance companies do win, in the sense that they are in a position to deny liability, to deny coverage. And at some point, if you don't get a court involved, that decision stands. Is this true?

Mr. FUGATE. I could not affirm that at all. What I do—

Mr. GREEN. Well, let me just ask you this, then. Okay, I—excuse me. Let me ask this question quickly. If the insurance company denies liability, and if the owner does nothing more, does the insurance company's judgment stand?

Mr. FUGATE. The adjustor's decision would stand, unless it was appealed.

Mr. GREEN. Okay. Let's assume that it is not appealed. The adjustor makes a decision in favor of the insurance company. True? That does happen, right?

Mr. FUGATE. The adjustor would determine if it was a flood or a wind impact, and would then—

Mr. GREEN. The adjustor decides that it is, in fact, flood and not wind. And you have the possibility of it being both. At that point, the insurance company does not have to pay any claim on that property with that decision. True?

Mr. FUGATE. It would depend on the policy.

Mr. GREEN. The policy will allow a payment when the adjustor says that it was water?

Mr. FUGATE. I don't know if you can state—and I would not have this experience—state categorically that an adjustor found that it was only flood and not wind. They may find that it is partial wind and—

Mr. GREEN. No, no, no. I am asking you—take as a fact that we have an adjustor who says it's flood, not wind. What then happens?

Mr. FUGATE. The flood insurance policy, if they have one, would then pay.

Mr. GREEN. All right. And the person, then, goes to court and wins the lawsuit. That means that the adjustor was wrong. Correct? If you go to court and win; this is not difficult, now.

Mr. FUGATE. That means the judge has made a ruling.

Mr. GREEN. Okay. Well, I'm taking it as a fact now that the judge has ruled that it was wind and not water. Does not the claimant win, then, the person who filed the lawsuit?

Mr. FUGATE. Hopefully, they will receive additional insurance dollars from their wind to help rebuild their home.

Mr. GREEN. Exactly. And that happens, doesn't it?

Mr. FUGATE. It has happened in my State, where lawsuits were filed against both wind and flood—

Mr. GREEN. And the point is this: If those persons don't have the resources to go to court, to do legal combat with the insurance company, they are just out of luck.

My point is, we can't allow that kind of de facto subsidy to continue. And I will yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. Mr. Marchant?

Mr. MARCHANT. Thank you, Madam Chairwoman. If the bill, as drafted, is passed and becomes law, will the homeowner have wind coverage with his homeowner's insurance, as well as wind coverage with the new program?

Mr. FUGATE. I do not know.

Ms. BROWN. It would depend on the homeowner's policy. GAO did a review a couple of years ago, looking at this issue. And one of the issues we raised is, would the private insurance market continue to offer wind. And if they do, you may have a situation that it would be covered in the private market, as part of the homeowner's policy, as well as a combination wind/flood policy.

Mr. MARCHANT. Which would present a whole different set of problems.

Ms. BROWN. Possibly.

Mr. MARCHANT. And that would be of deciding which party was then going to actually pay.

But if the Federal Flood Insurance Program covers the wind damage, then theoretically, if it's mandatory, the homeowner should be able to drop the wind damage on the residence.

Ms. BROWN. That would be a choice.

Mr. MARCHANT. Yes, and—

Ms. BROWN. That's an option.

Mr. MARCHANT. In theory, and only in theory, the premium will then go down for the homeowner.

Ms. BROWN. Correct.

Mr. MARCHANT. It could do that. So, the question of whether these properties will be double-covered, or whether the private market will completely withdraw wind coverage from its coverage—we had a similar thing happen in Texas on foundation coverage, where at some point the insurance companies said, "We're not going to cover foundations anymore."

Ms. BROWN. Well, the other issue that we raised in looking at this, if this structure were in place, and we maintained the WYO structure with the private sector selling the combined wind/flood coverage, it presents an opportunity for adverse selection, in that the insurance companies could choose to continue to offer wind to their lower-risk customers, and not offer wind coverage for higher-risk customers, which means that the highest-risk homeowners would migrate to the combined program.

Mr. MARCHANT. But if you had a situation where the homeowner's policy actually went down in cost, then the savings could be absorbed in a higher premium on the flood insurance. And then the program would not have to run in the hole as much. You could recoup some of the actual cost of the flood insurance.

Is it your opinion the bill is drafted that way, or is this still a question mark, as—

Ms. BROWN. I think part of this really will depend on how the private insurance market reacts to—if this were to become law, would they continue to offer the coverage in particular areas? So it really depends.

Mr. MARCHANT. Yes. For the Administrator, you testified that in the new mapping, there will be approximately 7 percent of area added to what would be the mandatory area?

Mr. FUGATE. That has been our finding, so far, sir.

Mr. MARCHANT. And 1 percent deducted. So you're going to have a net 6 percent added.

So, is there any reason to believe that with that increased 6 percent, you're going to have a huge increase in the number of properties that are going to have to have mandatory flood insurance when they go to closing on their house?

And in this case, does that translate into a program that is—becomes more solvent, and is able to pay its debt off, or does it make for a program that is going to create even more losses and even more debt?

Mr. FUGATE. The simple math would suggest, absent floods, we will have more revenue coming in. The reality is, you are basing it upon a 1 percent per annum risk, which means that these people are most likely to flood. And you are trying to then be actuarially sound by only the requirement that the policies be written at the highest risk.

So, you may see some short-term increase in funding. But the long-term exposure is actually greater. What the maps are doing, in many cases, is just more accurately depicting what that risk was. But again, because you are only requiring people to purchase flood insurance at the highest risk, that pool, even if it grows, does not offset the exposure. In fact, the exposure increases, even though without floods, it would give the appearance of increased revenue streams that may give some opportunity to pay down existing debt.

Mr. MARCHANT. Thank you.

Chairwoman WATERS. Mr. Taylor?

Mr. TAYLOR. I thank the gentlewoman. And to the gentleman's point, the Administrator said that the flood insurance lost $18.8 billion the year of Katrina. What he didn't tell you is that the Nation lost an additional $34.5 billion, because the private sector didn't pay their claims. Now, that was: $4.2 billion in FEMA housing-assisted payments; $7.1 billion in FEMA manufactured housing; HUD CDBG housing grants to the tune of $15.4 billion; and SBA disaster loans for $7.6 billion.

So, again, they keep looking at what the flood insurance lost. But because the private sector did not pay their fair share—the same reason that the insurance industry had $44 billion in net profits in 2005—our Nation lost $53 billion to Katrina. We are trying to keep that from happening again. We are trying to get those people who live in the high-risk areas to purchase a policy that will cover all these costs, so that we don't have to pay it again.

To that point, Mr. Fugate—and I'm sure you have had some time to look into this—you know that our agreement with the insurance industry lets them sell the policy, and they get a commission for that. We also pay them to adjust the claim. They get a paycheck for adjusting the claim. Our contract with the insurance industry says that they will do a fair adjustment of the claim. If it's 60 percent water and 40 percent wind, they pay 40 percent, and the Nation pays 60 percent through the Flood Insurance Program.

Unfortunately, testimony before the Mississippi Supreme Court by an attorney for the Nationwide Insurance Company—and I'm sure they hired the best to go before the Supreme Court of Mississippi—let's hear this. Justice Pierce—and this is a quote—"I am giving you the example. If 95 percent of a home is destroyed by wind, the flood comes in and gets the other 5 percent, and you know that, does your interpretation of the word 'sequence'—now he's talking to the attorney for Nationwide Insurance Company—mean that you pay 0?"

Mr. Landau, representing Nationwide Insurance Company, in testimony before the Mississippi Supreme Court, said, "Yes, your honor. They pay zero."

Now, going back to your job—you run the Federal Flood Insurance Program. You have testimony before the Mississippi Supreme Court where Nationwide Insurance Company's paid representative says in a circumstance where they should have been paying 95 percent of that bill, they pay 0, and stuck the Federal taxpayer with 100 percent of the bill.

What have you done to look into this? Because their contract with America says they have to have a fair adjustment of the claim. And to the gentleman's point, I am not an advocate of bigger government, except at times when government can do better than it's doing right now. And this is one of those times.

So, to that point, how many fraudulent claims has the National Flood Insurance Program looked into? Because I can't think of another single instance, Mr. Fugate—and you correct me—where someone can send an unlimited number of bills to the Federal Government for up to $350,000, and no one takes the time to see if it's a valid claim. And you have on record where that company admitted that if 95 percent of that burden was theirs, they pay nothing if the last 5 percent was done by the flood.

What have you done about this? Because I am just telling you, I am amazed at this Administration's reluctance to do something. Because doing nothing is to repeat this $53 billion mistake.

Mr. FUGATE. Congressman Taylor, to be specific, a lot of this is from Government Accountability Office recommendations we're implementing. But to the very point of what you are articulating, which is, how do you reconcile dual peril, written by two different individuals who have a conflict of interest, yet we're contracting with the insurance company to adjudicate, I actually have insurance companies come to us, asking to withdraw from the program. And we are currently looking at how would we provide claims adjustors on the Federal dollars to do what we currently pay insurance companies.

So, not only is this an issue that we know internally that we have to face, there are large insurance companies that are questioning why they want to continue this for this very reason, that it puts them in an untenable situation, where it questions their integrity when they're trying to reconcile how much was flood and how much was wind.

Mr. TAYLOR. Well, Mr. Fugate, again, what changes are you recommending so that this conflict of interest doesn't happen?

And, by the way, how many cases have you looked into where there obviously had to be fraud if they're admitting before the Mississippi Supreme Court that they are liable for 95 percent of the bill, but if there is 5 percent of damage caused by flooding, they are not paying anything, which means the Federal Flood Insurance Program and FEMA picked up the bill for all these additional expenses?

Mr. FUGATE. Congressman, I—

Mr. TAYLOR. Has it been—have you looked into one case?

Mr. FUGATE. Personally? I have not, sir.

Mr. TAYLOR. Has your Agency looked into one case?

Mr. FUGATE. I will need to respond for the record, so I can have the accurate information for that.

Mr. TAYLOR. Well, could you give me a guesstimate as to how many cases you have looked into?

Mr. FUGATE. No, Congressman, I cannot give you an estimate.

Mr. TAYLOR. You can't guess 1, 10, 20?

Mr. FUGATE. No, sir.

Mr. TAYLOR. A $53 billion bill, and nobody is looking to see if we should have paid it?

Mr. FUGATE. Again, to be accurate, I—

Mr. TAYLOR. Thank you, Madam Chairwoman.

Mr. FUGATE. —on the record.

Chairwoman WATERS. Thank you very much. We have 10 minutes left. We have to go up and take three votes. We're going to hear from Mr. Scalise, then we are going to recess and come back and hear from the third panel.

Thank you. Mr. Scalise?

Mr. SCALISE. Thank you, Chairwoman Waters. Administrator Fugate, I know we have worked on a lot of different hurricane recovery issues. We still have to work on some issues regarding the CDL loan forgiveness rules, but that's another issue for another day.

Regarding this, and kind of following up on Congressman Taylor and other Members' questions, regarding the actuarial soundness of the program, I agree that the $18.8 billion is a problem that has to be addressed, but it's a problem that was not caused and has no relation to the issue that Congressman Taylor and my bill addresses, and that is bringing the wind into the Flood Insurance Program. And, in fact, what I want to talk to you about is it's my feeling that the bill that we have would actually help solve the actuarial soundness of the program.

And, in fact, if you look at the CBO report on our bill, it confirms that it would be actuarially sound, and it would pay for itself. But what it would also do is I think it would address the heart of this problem that we're having right now, and that so many homeowners had, and that is the debate between wind versus flood.

It was such a frustration for so many of my constituents who bought a policy for—their homeowner's policy, it covered fire and theft, but it covered wind. And then they also paid for their flood insurance policy. And so they paid both, and then they got both. They got wind and flood damage. And yet, neither policy was going to pay, because each was pointing the finger at somebody else. And in many cases, you might have had somebody who lost their whole roof. So, clearly, there was going to be some wind damage. But the homeowner's policy was saying, "We're just pointing to the Flood Insurance Program. Make them pay."

And so, what happens is your program, NFIP, can only charge premiums right now, based on flood risk. And so you, by law, can only charge premiums for flood. But, in fact, you are paying claims for flood and for wind. You are paying for both, but you are only charging premiums for one. So you can't be actuarially sound under your current rules.

And, in fact, our bill would help fix that problem, because you eliminate the debate. No longer do you have two different people with, as the Government Accountability Office had suggested—two different people who have conflicts of interest. Because it's in the best interest of the insurance company to say, "Hey, if we can get NFIP to pay it, that's money we save."

Well, if you combine them into a multi-peril policy, now you are basing your premium on the combined risk, and you don't have this concurrent causation question any more. Because if it's caused by wind or by flood, it's all under one roof. It's all one policy and they are paying you that premium. And then, when you pay the claim, you are paying the claim, it doesn't matter whether it was wind or flood at that point. You are paying the claim because you charged the premium based on an actuarially sound matter to cover both.

But right now, under the current rules, you are paying claims for both, but you are only charging premiums for one. So I can see why you're in an actuarially unsound basis. Because for various reasons—and I hope you look into—the conversation between you and Congressman Taylor—and a lot of this happened before you got here—but clearly, the NFIP was paying claims for things that they had no business paying for. Because just through—and GAO gets into this, and they actually point out how there were those conflicts, and how the various insurance companies that chose to do this just said, "For everything we can dump onto the flood program, we will make them pay," because they will.

And, unfortunately, you all held up your end of the bargain and you paid claims, but there were so many people who were waiting and had to go to court, take their insurance company to court to make them pay for the wind damage that was done, even though they paid on the policy.

And the other thing that this policy has is it has loss of use. The policy in our bill, it has a loss of use program. So what it also does is addresses the problem of those FEMA trailers for so many people who had to wait maybe 2 years, and maybe they finally got paid for their insurance claims, but they had to wait 2 years and they were living in a FEMA trailer, because they had no means to live.

And so, with a loss of use component that is also actuarially sound, now that will also be paid for not through your separate program that the FEMA trailer has dealt with, but also through their actuarially sound multi-peril claim.

So, I just wanted to talk about all that. Because I think as you are looking at how it affects your program, I think it helps the actuarial soundness of the Flood Insurance Program by combining the perils, so you don't have to pay for somebody else's damage.

Mr. FUGATE. That has a lot of interesting points. However, the reason I am 25 percent below has nothing to do with that. And there may be some degree, but I can't quantify that. The reason I am 25 percent below actuarial rate is when Congress reauthorized a Flood Insurance Program in 1994, they limited the annual increase to 10 percent per annum. So I cannot—if you remap and you find areas at higher risk, I can only move up a certain amount. And so that leaves me not able to be actuarially sound, because I am capped at a 10 percent increase in the program.

Mr. SCALISE. Yes, but that's on flood. This—

Mr. FUGATE. That would—

Mr. SCALISE. The wind program is a totally separate program, and requires actuarial soundness.

Mr. FUGATE. I am—

Mr. SCALISE. And I know I'm out of time. I apologize. Thank you.

Chairwoman WATERS. Thank you very much. And our bill will move that up from 10 percent to 20 percent, so you will have a little bit more flexibility.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record. This panel will stand in recess until after the votes. We will be back.

[recess]

Chairwoman WATERS. Our first witness will be Mr. David R. Conrad, senior water resources specialist, National Wildlife Federation.

Our second witness will be Mr. Mark Davey, president and chief executive officer, Fidelity National Insurance Company, on behalf of the Write-Your-Own Coalition.

Our third witness will be Mr. Larry Larson, executive director, Association of State Floodplain Managers.

Our fourth witness will be Mr. John Rollins, president, Rollins Analytics, Inc..

Our fifth witness will be Mr. Barry Rutenberg, 2010 second vice chairman of the board, National Association of Home Builders.

And our final witness will be Mr. Maurice Veissi, Veissi & Associates, 2010 first vice president, National Association of REALTORS.

Without objection, your written statements will be made a part of the record. You will now be recognized for a 5-minute summary of your testimony.

So, let us start with Mr. Conrad.

STATEMENT OF DAVID R. CONRAD, SENIOR WATER RESOURCES SPECIALIST, NATIONAL WILDLIFE FEDERATION

Mr. CONRAD. Good afternoon, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. My name is David Conrad, and I serve as senior water resources specialist for the National Wildlife Federation, the Nation's largest conservation, education, and advocacy organization. We greatly appreciate the subcommittee's holding this hearing today, and your continuing interest in the reform and reauthorization of the National Flood Insurance Program.

I want to underscore three major points from my written testimony. First, while the National Flood Insurance Program is broken, essentially bankrupt with a debt of $18.7 billion to the U.S. Treasury, many of its fundamental problems can be corrected. This committee has an opportunity to pass meaningful reforms that will get the program on better fiscal footing and, most importantly, provide better protection for people, communities, and the environment. Unfortunately, the discussion draft, or the flood insurance reform bill, falls far short of what is needed, and may even make things worse.

Second, these are not normal times. The Nation's scientists are telling us that climate change is already causing heavier rainfall, changing patterns of snowfall, bringing more severe hurricanes, and increasing sea levels, all of which will increase flooding risk and likely exacerbate already increasing flooding damage.

Third, tomorrow is Earth Day. And it's important to recognize that the NFIP, as it is currently functioning, is leading to increasing development and damages to wildlife habitat, wetlands, coastlines, and other environmental resources. We need to fix these perverse incentives for more development and redevelopment in these environmentally sensitive high-risk areas.

Unfortunately, the committee is considering adding wind storm coverage to the NFIP, and establishing a Federal backstop for State natural catastrophe funds. In our view, these are anti-environmental proposals that would exacerbate these problems.

Let me comment directly on the National Flood Insurance Reform Priorities Act, the discussion draft that we received. First, what we like. We support the 5-year phase-out of pre-FIRM subsidies for two major classes of properties: non-residential properties; and non-primary residences. We also support increasing from 10 to 20 percent the amount that FEMA can annually raise premiums to reduce subsidies and improve the NFIP's actuarial soundness.

Now, what we think needs to be fixed, expanded, or eliminated in the discussion draft. The bill should be amended to phase out subsidies for severe repetitive loss properties, and properties that have already cost the Flood Insurance Program more than the value of the home or business in cumulative claims.

We would strongly object to sections 6 and 10, that would delay or waive requirements for mandatory purchase, where residents remain vulnerable and inadequately protected from flooding. As we saw in Hurricane Katrina, it's a dangerous mistake to assume no flood insurance is necessary because there are Corps of Engineers or other levees, especially decertified levees.

We also believe the NFIP should be reauthorized for 3 years, and not 5 years. Administrator Fugate has initiated a major 2-year effort to review the NFIP, with the intent to make comprehensive, administrative, and legislative recommendations to guide the course of the program in the future. The next reauthorization should dovetail closely with the Administration's efforts.

Now, another overriding concern. Given the committee's decision to limit this reauthorization to insurance and finance aspects, we believe many of the most critical and necessary reforms are not being made in this bill, including needed measures that can better target assistance to low-income Americans, to improve land use planning and building codes, and to make hazard mitigation and environmental protection the heart of NFIP's risk reduction strategy.

Regarding H.R. 1264, we do not believe the Federal Government should get into the business of assuming liabilities and responsibilities for wind coverage. Not only would such an expansion of the NFIP threaten the program's long-term financial health, it would also fuel development in many more high-risk and environmentally sensitive areas.

In conclusion, once again, the National Wildlife Federation greatly appreciates the opportunity to provide our views on legislation to reform the NFIP. Many of the views we have expressed are shared by Smarter Safer, a broad coalition working to advance far-sided policies to better protect communities and the environment.

We look forward to working with the committee as the process continues, and I look forward to responding to any questions the members may have. Thank you.

[The prepared statement of Mr. Conrad can be found on page 100 of the appendix.]

Chairwoman WATERS. Thank you.

Our next witness will be Mr. Mark Davey.

STATEMENT OF MARK DAVEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FIDELITY NATIONAL INSURANCE COMPANY, ON BEHALF OF THE WRITE-YOUR-OWN FLOOD INSURANCE COALITION

Mr. DAVEY. Madam Chairwoman, Ranking Member Capito, and subcommittee members, my name is Mark Davey, and I am president and CEO of Fidelity National Insurance Company. Fidelity is a write-your-own flood insurance partner with the NFIP, and the largest writer of flood insurance in the Nation. We are also a member of the Write-Your-Own Coalition, which is made up of 85 private insurers who collectively administer 95 percent of the NFIP's policy base.

Thank you for the opportunity to testify today on behalf of Fidelity National and the Write-Your-Own Coalition, and to share our views on proposed flood insurance reform legislation.

First and foremost, we would like to compliment and voice our support for the draft flood insurance legislation authored by Representative Waters. We feel the bill provides much-needed stability and refinement for the betterment of the National Flood Insurance Program.

I would like to directly respond to the questions you proposed. You requested we share our views, relative to the status of the NFIP, and any improvements the program may need. All things considered, the program is functioning well, in spite of numerous program expiration and delays in reauthorization. While the program remains heavily in debt, the NFIP has successfully retired $500 million of debt accumulated from Hurricanes Katrina, Rita, and Wilma. Not only has the program retired $500 million of debt, it has also shouldered the additional burden of Hurricane Ike during the same time frame.

The Flood Program and the stakeholders would greatly benefit from streamlining and simplifying the flat application process. A streamlined policy application and underwriting process would enable more agencies to understand a market flood insurance.

Purchasing a traditional homeowner's policy through our organization takes an agent approximately 5 minutes to complete the transaction. By contrast, even with a highly automated Web-based flat application process, a proficient flood producer in most circumstances will invest several hours before successfully placing a flood policy.

There needs to be a continued push for adequate rates at all program levels. Our goal should be to create a program which can be financially self-sufficient. The program cannot survive and meet its responsibilities if its existence comes in question each time the NFIP has to ask Congress for more money.

Not in the bill, but something I proposed, is the inclusion of additional living expense coverage. Adding this coverage will provide a valuable coverage, which will allow policyholders to get back on their feet much faster following a flood event. This coverage will provide the ability for the insured to keep their lives on track, as opposed to being thrown out on the streets. I advocate we add this additional coverage and charge an appropriate premium to properly underwrite this new proposed coverage.

You asked in what ways the long-term reauthorization brings stability to the housing market. When a buyer of a property located within a special flood hazard area is confronted with the inability to buy flood insurance, it often derails the transaction, leading to the cancellation of the purchase. In some circumstances, purchase transactions have been abandoned, based on buyers' well-founded fears of their inability to secure flood insurance for the duration of their ownership. The lack of immediate flood coverage has an extremely negative effect on housing sales in mandatory flood zones.

You asked me to discuss how short-term reauthorizations have impacted our company and our clients. Lapses are extremely difficult to manage. We endeavor to run our operations as efficiently as possible. Our computer mail-in phone systems are matched to our daily work loads, both from a customer service standpoint and a computer systems standpoint. Digging out of a backlog accumulated by program lapses is extremely difficult, and we cannot provide the level of service to our customers to which they are accustomed.

With the recent lapse, we were confronted with issuing approximately 5 percent of our annual policy's renewal notices and other necessary documents immediately upon program reinstatement.

When our production platforms normally run 8 to 10 hours a day, 7 days a week, the catch-up window dictates double and triple shifting, which is extremely costly and disruptive.

Lapses cause undue stress, confusion, and frustration to policyholders and potential policyholders. Because we are always hopeful appropriate action will be taken to avoid lapses, in every circumstance we have to scramble to notify and educate the general population and all those involved in the Flood Program of lapse, and our current changes in procedures when, in fact, we do fall into a lapse environment.

The non-quantifiable and most costly aspect is the loss of new and renewal policies, not just in special flood hazard areas, but also areas that the flood insurance is not mandatory. Policyholders contemplating renewing their policies with limited disposal are far less likely to renew if they feel the program's existence is in jeopardy. As we do everything possible to encourage program participation, the worst message we can convey is the program's continuation is in question.

You asked me to discuss what impact the map modernization effort has had on write-your-own companies. Continued and refined map modernization is essential for the health of the NFIP. It is imperative we provide consumers with the most accurate information available.

[The prepared statement of Mr. Davey can be found on page 112 of the appendix.]

Chairwoman WATERS. Thank you very much.

Our third witness will be Mr. Larson.

STATEMENT OF LARRY LARSON, EXECUTIVE DIRECTOR, ASSOCIATION OF STATE FLOODPLAIN MANAGERS

Mr. LARSON. Thank you, Madam Chairwoman, and members of the subcommittee. The Association of State Floodplain Managers' 14,000 members implement the National Flood Insurance Program at the State and local level, and I represent their thoughts.

The NFIP really is no different than it has been for the last 42 years. It is, essentially, the same program that was authorized in 1968. Congress has tweaked the edges here and there over time, but we're essentially operating on that same model. This bill, again, tweaks around the edges. We are concerned with significant reform to the program, and we are pleased that FEMA is undertaking an effort to come back to you with some broad recommendations on options in which that needs to happen.

Significant changes are needed to address its debt and the inability to reduce flood losses in the Nation, which continue to go up, despite the program being here for 42 years. And, despite all the flood control projects that we built in the last 80 years, we are still increasing flood damages significantly, which doubled in the last decade per year.

Ideas, big ideas, need to be thought about. Is it time to turn flood over to the private sector? Is there any reason the private sector can't run flood insurance right now? That needs to be considered.

Floods are getting bigger. We are going to have more damages. There is more property at risk. And that's the big issue. Risk is the probability of getting flooded times the consequences if you are flooded. Probabilities have not changed significantly, but consequences have changed dramatically. Building in high-cost coastal areas, building behind levees, all those consequences are going up greatly. And we're not going to be able to control that under the current process.

We are seeing more intense storms. People in Des Moines have said, "We have had three 500-year floods in the last 15 years." We are seeing more intense rainfalls. We are seeing sea-level rise. We are seeing these things that will increase our risk. So, significant program changes are necessary.

These issues we are dealing with: the struggles we are having now with mapping and levees and insurance—mapping is not the issue. Mapping merely identifies the risk. And we need to know that. Levees are not the issue. We know that all levees will fail or overtop at some point. That's not just me saying that, that's every expert in the world saying that.

Insurance is the only security some of those people have for what they own, which typically is the only thing they own—that house. Without insurance, they're left naked.

So, delaying the map without insurance puts people in this situation such as Representative Taylor—where now there is no way to regain that loss that they had. Other options that are in the bill such as phasing in, those sorts of things, seem to make a lot more sense. The PRP, Preferred Risk Policy—or the policy that FEMA has talked about, some of those options.

In the Nation, about 1 percent of the people are at risk of flooding. Seven percent of the land area of the Nation is floodplain, but only about 1 percent of the people are at risk of flooding. About half of those people carry insurance. And as Mr. Fugate talked about, trying to figure out how to run an actuarially sound program when there are only very few of those 11 million structures that are required to have insurance is problematic.

So, broadening that risk, or broadening that base, spreading that risk, is how you have to get an actuarial program.

We would agree with the GAO concern that part of this issue is who benefits and who pays, and striking that balance. Do those who live at risk pay their appropriate share of living at risk, or is that being paid for by the rest of us who don't live at risk? That's the challenge that you face in this committee, and that Congress faces in trying to actually reform this program.

I will respond to other questions as you have them. Thank you very much.

[The prepared statement of Mr. Larson can be found on page 125 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Rollins?

STATEMENT OF JOHN W. ROLLINS, PRESIDENT, ROLLINS ANALYTICS, INC.

Mr. ROLLINS. Good afternoon, Chairwoman Waters, and Ranking Member Capito. My name is John Rollins. I am an actuary holding qualifications in the Casualty Actuarial Society and American Academy of Actuaries. I have worked in Florida property insurance for the last 11 years, serving as chief actuary of private insurance companies, as well as a director at the State-run wind pool of Citizens Property Insurance Corporation. I have testified to lawmakers in Florida and other States on the issue of government-backed property insurance systems in disaster-prone areas, and published some research papers on the subject.

After many years of observing public policy decisions and their impact on property insurance markets as well as public finances, my message to you today is simply this: in designing rates for any property insurance program ultimately supported by taxpayer capital, great care should be taken that the legislative definition and the practical definition of the phrase “actuarially sound” conforms to the principles of the U.S. casualty actuarial profession itself.

Some background is in order. We know that an insurance policy is really just a promise to pay for a predefined type of possible loss in exchange for some up-front premium. Now, by law, insurance contracts must be backed by capital sufficient to pay the claims, even when many claims occur at the same time, and the costs are well in excess of the premiums charged.

Disasters, by definition, are infrequent, unpredictable, and severe. And for these events, the required capital can be catastrophic as well: 20 or more times the average annual loss, for example, contemplated in the premium.

The job of actuaries is to determine that fair premium. But the job becomes more difficult when the losses are catastrophic, and yet more difficult when the supporting capital for the insurance is provided in other than some kind of economic transaction, such as through government support.

The relevant actuarial principle states, “A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.”

Each word or phrase in that statement has implications for pricing decisions for these government-backed insurance programs. First, the phrase “not excessive, inadequate, or unfairly discriminatory,” you may recognize as the definition of a lawful rate under most State insurance laws. So actuarial soundness is historically a sufficient condition for a lawful rate. Or, said another way, it’s hard to imagine a rate which would be actuarially sound yet unlawful.

Second, those rates must reflect expected costs. So, it’s not sound to peg the rate to the most favorable outcome or the most unfavorable outcome, or whatever is convenient. Rates have to reflect the probability-weighted average over all the scientifically tenable outcomes. What that means in catastrophe rate-making is that scientific models and simulation models are very useful, since any recent snapshot of activity may show bad disasters or may show no disasters.

Third, such rates have to reflect all costs, not just those we prefer to reflect, or that we can easily quantify. Rates have to be made on a cost basis, rather than an economic basis. But real costs incurred to issue a properly capitalized policy must be reflected.

Fourth, such rates are to reflect future costs. Rates may not be made to recoup past losses. So, past data may or may not be predictive of future losses, but past experience is not some kind of an account to be squared by raising or lowering future premiums.

And, finally, actuarially sound rates must reflect the cost of risk transfer. What that means is they have to include a provision for the cost of that capital, required on demand to pay claims after catastrophic events. Private insurers transfer risk through reinsurance and risk sharing arrangements, and they pay those costs immediately. Government programs can borrow from future taxpayers to fund today's risks. The cost of that capital may be arguable, but actuaries and economists agree that it should not be zero.

Therefore, the key is that an actuarially sound rate for a government-backed insurance program must be greater than simply the expected annual loss to the program, plus provisions for the known expenses.

Failure to implement actuarially sound rates in such programs at both the State and Federal levels has had unwelcome consequences, as testified by many of my colleagues here at the table, including: overdevelopment of environmentally sensitive areas, as these low insurance rates offered by government-backed insurers and subsidized by future taxpayers encourage consumers and developers to underestimate the risk and build in harm's way; expansion of the risk in government-backed insurance pools, as the private insurers may retreat from the areas in which they cannot or will not compete with these subsidized rates; and crowding out of that capital, which otherwise would be at risk in lieu of the taxpayer capital we put at risk; depletion of the public treasury, as new debt must be incurred and then serviced, as you have heard over the course of the hearing with the National Flood Insurance Program, by potentially generations of taxpayers.

Finally, wealth transfers from all taxpayers to an often high-income subset of residents that choose to live in risky but perhaps picturesque areas, because all taxpayers pay proportionately to service the debt incurred to these underfunded programs.

Despite the fact that enabling legislation frequently utilizes phrases like "actuarially indicated," or "actuarially sound," the rates for those programs, in practice, may not measure up. So I urge lawmakers to carefully define the concept of actuarially sound rates during the legislation development and continuing implementation of these programs.

And I thank you for the opportunity to appear before you.

[The prepared statement of Mr. Rollins can be found on page 142 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Rutenberg?

STATEMENT OF BARRY RUTENBERG, 2010 SECOND VICE CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. RUTENBERG. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for the opportunity to testify today. My name is Barry Rutenberg, and I am the 2010 second vice chairman of the board of the directors of the National Association of Homebuilders. I am also a builder and developer from Gainesville, Florida.

NAHB commends the subcommittee for addressing reform of the NFIP program, and releasing a draft flood insurance bill that includes a much-needed long-term extension and reauthorization of the program. For the last several years, the NFIP has had to undergo a series of short-term extensions that have created a high level of uncertainty in the program.

The NFIP recently experienced several short-term authorization lapses, causing severe problems for our Nation's already troubled housing markets. Unfortunately, during this latest delay, many home buyers faced delayed or canceled closings, due to the inability to obtain NFIP insurance for a mortgage.

In other instances, builders themselves were forced to delay or to stop or delay construction on a new home, due to the lack of flood insurance approval. NAHB supports this long-term extension to ensure the Nation's real estate markets operate smoothly and without delay.

FEMA's Flood Insurance Program plays a critical role in directing the use of flood-prone areas and managing the risk of flooding for residential properties. The availability and the affordability of flood insurance gives local governments the ability to plan and zone its entire community, including floodplains. In addition, if a local government deems an area fit for residential building, flood insurance allows home buyers and homeowners the opportunity to live in a home of their choice in a location of their choice.

The home building industry depends upon the NFIP to be annually predictable, universally available, and fiscally viable. Unfortunately, the losses suffered in the 2004 and 2005 hurricane seasons included the devastation brought about by Hurricanes Katrina, Rita, and Wilma. They have severely taxed and threatened the solvency of the NFIP.

According to FEMA, between NFIP's inception in 1968 through 2004, a total of $15 billion has been needed to cover more than $1.3 million in losses. However, the combined claims for 2004 and 2005 exceeded the total amount paid during the entire 37-year existence of the NFIP program.

While these losses are severe, they are currently unprecedented in the history of this important program. And, in our opinion, they are not a reflection of a fundamentally broken program. Nevertheless, NAHP recognizes the need to ensure the long-term financial stability of the NFIP, and looks forward to working with this committee to implement needed reforms. While my testimony goes into more detail, it is absolutely critical that Congress approaches legislation with care.

The NFIP is not simply about flood insurance premiums and pay-outs. Rather, it is a comprehensive program that guides future development and mitigates against future losses. While a financially stable NFIP is in all of our interests, the steps that Congress takes to ensure financial stability has the potential to greatly impact housing affordability, and the ability of local communities to exercise control over their growth and development options.

While NAHB supports a number of reforms designed to allow the NFIP to better adapt to changes in the marketplace, we have strongly advocated against expansion of the regulated floodplain, or changes to the numbers, locations, or types of structures required to be covered by flood insurance without appropriate study first. Before any such changes could be implemented, FEMA should first demonstrate that the result that the resulting impacts on property owners, local communities, and local land use are more than offset by the increased premiums generated and the hazard mitigation steps taken.

NAHB is, therefore, pleased that the subcommittee's draft bill requires that FEMA conduct a study on the feasibility and implications of a change to NFIP's mandatory purchase requirements within the 100-year floodplain.

Finally, NAHB is pleased to support H.R. 1264, the Multiple Peril Insurance Act of 2009, authored by Representative Gene Taylor. Coverage for wind insurance would provide a needed addition to the availability and affordability of property insurance in high-hazard areas. NAHB is pleased that H.R. 1264 references the mitigation requirements of consensus-based building codes as a measure to lessen the potential damage caused by a natural disaster, and, thus, further ensure the financial stability of the NFIP.

Again, thank you for the opportunity to testify today.

[The prepared statement of Mr. Rutenberg can be found on page 144 of the appendix.]

Chairwoman WATERS. Thank you very much.

Our final witness will be Mr. Maurice Veissi.

STATEMENT OF MAURICE VEISSI, VEISSI & ASSOCIATES, 2010 FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

Mr. VEISSI. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, I want to thank you for inviting me to testify today regarding legislation to reform the National Flood Insurance Program. My name is Moe Veissi. I am currently the 2010 first vice president in the National Association of REALTORS. I have been a Realtor for more than 40 years. I am the broker-owner of Veissi & Associates, Inc., and TM Realty, the former in Miami and the latter in Daytona, Florida. I am here to represent the views of the National Association of REALTORS and its 1.2 million members who are engaged in all the aspects of residential and commercial real estate in the 50 States and 4 territories of the United States.

Throughout its existence, the National Flood Insurance Program has effectively reduced the cost to taxpayers of flood damage. It does that by requiring communities who wish to participate in this valuable program to implement flood plan management ordinances. It is important to note, according to FEMA, those requirements reduce flood damage by about $1 billion a year.

In other words, participation in this program ensures that a $1 billion savings is passed on to the taxpayers who do not have to shoulder the enormous expense of underinsured property owners after a natural disaster like Hurricane Katrina.

It is estimated that a third of the $88 billion in remedial efforts that the government spent on disaster was due to underinsured properties. And while the National Flood Insurance Program has been effective at reducing societal costs, flooding and damages since 2005 highlight the need to reform the program so that it can better protect our people and put this program on a strong financial footing.

Just look at the recent floods in Rhode Island. We all saw the images of the Pawtucket River, cresting at about 12.5 feet above flood grade. The residential experienced huge damage in a flood characterized as 1 event in the last 200 years. NAR president-elect Ron Phipps experienced water above 21 feet of mean level. Imagine the horror of having to fill a 30-year dumpster with parts of your family's memories and history. That must have been devastating.

Extending the Flood Program month to month through stop-gap measures—some might say punting from one deadline to another—is an ineffective way to operate a major Federal program. And this creates financial and real estate market uncertainties for millions of taxpayers, financial market lenders, and insurers who can't or won't operate under these uncertainties.

The National Association of REALTORS supports a minimum 5-year authorization of the flood program. Such an extension provides much-needed certainty to a recovering real estate market and to millions of taxpayers who depend on this important program.

NAR also supports reforms that strengthen the program's financial footing. Increasing participation would lead to increased funds for the program, help property owners recover from flood losses, and decrease future Federal assistance with underinsured properties and owners experience losses such as happened before.

We support reforms that would eliminate discount insurance rates for older properties with a history of repeated pay-outs where the owner has refused to mitigate against future insured losses. Yet we oppose changes to rates—charge pre-flood insurance rate mapped commercial properties, non-primary residential or primary residential homes.

Pre-flood mapped properties facing identical risks should have the same rate. The rate should not be based directly or indirectly on the type of occupancy or the income or assets of the owner. That way, two properties could be located next to each other, but the commercial property could get a bill that is about 4 times more than the one right next door. That's not right.

H.R. 1264, the Multiple Peril Insurance Act sponsored by Representative Taylor, would ensure access to affordable insurance for wind-related hurricane damage, and therefore, reduce the amount of post-disaster Federal assistance, saving taxpayers real money. Covering both wind and flood would eliminate the insurance pushback on what causes the damage.

As we have learned in the past in Rhode Island; Florida; Fargo, North Dakota; Louisiana; and a host of other hometowns across this great land, it's far less costly to prepare ahead of time for disasters than it is to fund recovery efforts.

In conclusion, thank you again for the opportunity to share the Realtor community's views on the National Flood Insurance Program. The National Association of REALTORS stands ready to work with members of the committee to develop meaningful reforms to this program that will help protect the country's property owners and renters to prepare and recover from future losses resulting from floods. Thank you so very much.

[The prepared statement of Mr. Veissi can be found on page 154 of the appendix.]

Chairwoman WATERS. Thank you very much. And I will now recognize myself for 5 minutes for questions.

Let me turn to Mr. Davey. You mentioned in your oral testimony the need for the program to offer additional living expense coverage. I am interested in this concept, since you talk about helping low-income Americans. Can you delve further into how this would work?

Mr. DAVEY. Additional living expense was referred to as ALE—is an essential part of a traditional homeowner's policy.

Whether your house is damaged by flood, or whether it's damaged by fire, the first thing you have to do when you're found without a home, is you have to relocate. And your first immediate need is cash. You have to go rent a hotel, you have to start purchasing your initial meals at a restaurant. You need money.

When your house is flooded, you have lost everything, in most circumstances you don't have access to anything in your household. You have to go purchase clothing, start feeding yourself, find suitable shelter. That is—if there is one thing that happens after a flooding event that's most crucial, the first calls we receive are people looking for this additional living expense.

Chairwoman WATERS. But wouldn't that increase the price of the premium?

Mr. DAVEY. It would increase the price of the premium. It could be made optional or it could be made mandatory. And I don't advocate giving the coverage away. I advocate charging the actuarially sound premium for that coverage.

But it is an absolute need of the policyholder after their property has been flooded.

Chairwoman WATERS. You heard earlier this morning the Administrator say that, by law, they were only able to increase premiums by 10 percent, or the amount that they were able to charge. We said we would increase by 20 percent. Do you think this is enough to incorporate into it additional coverage for those who would want to have this ADL?

Mr. DAVEY. Additional living expense? I don't think it falls in the category of an increased premium. It's a newly introduced coverage. So any premium associated with that coverage would not be construed as an increase of our—of the NFIP's rates. It's a new coverage, of which—if it's made optional, it's at the purchaser's election whether they choose to purchase that coverage or not choose that purchase.

Chairwoman WATERS. Okay. I'm sorry, it's ALE, that's what—additional living expenses.

Mr. DAVEY. Correct.

Chairwoman WATERS. Now, could your company offer that?

Mr. DAVEY. Could our company offer it outside of the flood policy?

Chairwoman WATERS. Yes.

Mr. DAVEY. There are companies that have written that coverage outside of the flood policy. Unfortunately, the areas in which they offer it aren't always areas of highest needs. That may be available through companies—through a—what they call a companion policy that is written in conjunction with the NFIP.

Chairwoman WATERS. All right. Let me just ask—Mr. Veissi, I have heard reports that during this month's lapse in the Flood Insurance Program, each day up to 1,400 home buyers were unable to close on their homes. How did this lapse impact the real estate market and home buyers?

Mr. VEISSI. At a time when the real estate home market is beginning to now fire up and, from an economic standpoint, support the economy, it could be devastating.

The reality is that most lenders will not loan on a home that is not sufficiently insured. And so, if you can't get flood—or wind, for that matter—then those impediments would stop—literally, stop—the sale in many of the coastal areas. Remember, about 1 out of every 2 Americans live within 50 miles of the coast. The effect of that could be absolutely devastating.

Chairwoman WATERS. Thank you very much. And I know that Mr. Taylor is here, and he is going to talk a lot more about wind insurance. But Mr. Veissi, can you discuss the importance of this legislation and how it's needed to protect homeowners in areas prone to wind damage?

That's for Mr. Rutenberg or Mr. Veissi.

Mr. VEISSI. I would be more than happy to. The reality is, especially in coastal areas where there are two types of flood—one type is wind-driven flood and the other is flood as we would imagine it in Rhode Island and some of the other areas.

The bounce back between the insurance company and the insured can get very dramatic. In one case, the wind-driven flood may be—the insurer may want compensation from that, and the insurance company will say, "No, that's flood."

And then, from the flood standpoint, that insured will go back to the flood and say, "Well, I need to be compensated for this," and that insurer would say, "No, no, that's wind-driven damage."

The impact of that is absolutely enormous. You have two insurance companies battling against one another, not wanting to pay. I can understand that. But understanding that something happened to that one homeowner, that one homeowner needs to be compensated. Combining those two together would be absolutely the case.

Chairwoman WATERS. Thank you. Ms. Capito?

Mrs. CAPITO. Thank you. Mr. Davey, I have a question. If somebody is getting an FHA mortgage, and they happen to fall within the FEMA floodplain, are they required to get flood insurance for that?

Mr. DAVEY. They are. Yes, they are.

Mrs. CAPITO. And how is that priced? Mr. Rollins has raised big questions about whether the rates are actuarially sound. How do you—I assume you do this in your regular line of business—calculate that? And what kind of concessions do you have to find if it's going to be subsidized or otherwise? Do you do income ratios, or what?

Mr. DAVEY. I am not sure I understand the question.

Mrs. CAPITO. When you're writing a flood policy, an NFIP policy. You do that, correct?

Mr. DAVEY. The pricing mechanism?

Mrs. CAPITO. Yes. How do you determine what the rate is on that, and—

Mr. DAVEY. The NFIP has set rating guidelines and rating protocols that we follow.

Mrs. CAPITO. So you can't go away from that?

Mr. DAVEY. No, no. We adhere strictly to the rates that are set by the NFIP.

Mrs. CAPITO. Okay. Okay, thank you. Mr. Rollins, you really raised some questions on whether the rates are actuarially sound. And with a program that is $18 billion in debt, I think that's a logical question.

What improvements would you make to set this on the right course actuarially, or with rate setting?

Mr. ROLLINS. Thank you, Ranking Member Capito. Each program has to stand on its own, from the standpoint of being actuarially sound. So an actuarially sound rating plan for car insurance or wind insurance is not the same, is not necessarily going to be based on the same factors as one for flood insurance.

But that said, all actuarially sound programs share one common characteristic, which is that they properly account for the present value of all expected future costs associated with the risk. And that includes not only the—sort of the run-of-the-mill average annual losses, but they have to include some kind of loading or provision to reflect the fact that a severe year may occur, particularly in a program that's subject to catastrophes, whether that be wind, earthquake, or flood. And that loading can be significant.

Now, my experience, admittedly, is more with coastal property and wind than it is with the NFIP's rating structure. But that loading—what troubles me, as an actuary, is that loading is rarely recognized as a matter of legislative definition or as a matter of practical definition within the rating plan.

So, what you end up with is a program that apparently is actuarially sound for perhaps a number of years, and then a loss many times the annual premium can overwhelm that. And it's easy to then look back and say, "If we were to distribute this cost over the past 10 or 20 years, we could have had the right loading."

But it's—as one major insurance company famously said, they lost 50 years of premiums in 5 hours in Hurricane Andrew.

Mrs. CAPITO. Right.

Mr. ROLLINS. That would be prima facie evidence that the program was not actuarially sound.

Mrs. CAPITO. Okay. Mr. Conrad, I understand you are a proponent of flood insurance reform, and are concerned that the program continues to be weighted down by repetitive loss properties. And according to a recent report by the Congressional Budget Office, in a study sample, about 40 percent of subsidized coastal NFIP properties were worth at least half a million dollars. I would imagine that some of these might be repetitive loss properties.

How would adding wind coverage, in your opinion, to the troubled NFIP exacerbate these problems?

Mr. CONRAD. Unless and until we address the repetitive loss problem in the Flood Insurance Program, we have a program that is always in a downward spiral with repetitive losses.

I believe that if you were to—and the estimate—there have been some estimates about how much that's costing a year. And I'm not sure that we have actually plumbed that completely to the depth, even at FEMA. But to add wind in this area—FEMA has no experience with wind at this point. So, at least in the first decade, they would be shooting in the dark in terms of how to do wind.

I think what—the effect would be to just increase the uncertainty and the risk in the Flood Insurance Program that is already sort of there because of a number of different factors in the way the repetitive loss problems are plaguing the program.

Mrs. CAPITO. All right. Thank you.

Chairwoman WATERS. Thank you very much. I am going to hold each person to the 5 minutes. We have to be out of the room for the Financial Services Committee to come in. So, with that, Mr. Cleaver for 5 minutes.

Mr. CLEAVER. I yield back my time, Madam Chairwoman.

Chairwoman WATERS. Thank you. Mr. Green, for 5 minutes.

Mr. GREEN. I will yield my time to Mr. Taylor, Madam Chairwoman, and thank you very much.

Chairwoman WATERS. Thank you very much. Mr. Taylor?

Mr. TAYLOR. I would like to address this question to you, Mr. Davey, as a representative of the National Flood Insurance Program.

Your contract with America calls for a fair adjustment of the claim by your personnel. You are paid to sell the policy, you are paid to adjust the claim. Are you aware that, within 2 weeks of Hurricane Katrina, State Farm sent an internal company memo that instructed their adjustors—and this is a quote—"Where wind acts concurrently with flooding to cause damage to the insurer's property, coverage for the loss exists only under flood coverage." Now, that's an instruction to their adjustors. Does that sound to you like a fair adjustment of the claim?

Mr. DAVEY. Representative Taylor, I can't comment on State Farm's practices. What I can share with you—

Mr. TAYLOR. Okay. If I may—

Mr. DAVEY. —is the practices we engaged in, which did not invoke the anti-concurrent clause in the settlement of our property claims as a result of Hurricanes Katrina, Rita, and Wilma.

Mr. TAYLOR. All right. Well, let me ask you, since it was not an isolated instance, in testimony before the Mississippi Supreme Court, a hand-picked attorney for Nationwide Insurance Company was posed a question by Justice Pierce of the Mississippi Supreme Court: "I am giving you the example of 95 percent of the house is destroyed by wind. The flood comes in and gets the other 5 percent, and you know that. Does your interpretation of the word 'sequence' mean you pay 0?"

The lawyer for Nationwide Insurance Company, Mr. Landau, answered, "Yes, your Honor," which means they pay zero. Does that sound like a fair adjustment of the claim?

Mr. DAVEY. I—

Mr. TAYLOR. Come on, you have to have an opinion, sir.

Mr. DAVEY. I can't comment on the fashion in which they adjusted our claims. I can tell you how we adjusted our claims. Where there was 60 percent of the responsibility coming from wind and

40 coming from water, we paid our 60, and the water paid 40. We did not invoke the anti-concurrent clause in the settlement of any Katrina, Rita, or Wilma claims.

Furthermore, for every loss—and we were a substantial player, we represented roughly 30, probably 35 percent of the market share in the Louisiana area—we employed a separate adjustor specifically to adjust flood losses, and the insurance companies that had the property had their own adjustor to adjust the wind side.

So, where we were the write-your-own character providing the flood coverage, there was a separate adjustor specifically assigned to appraise the damages arising from flood and flood only.

Mr. TAYLOR. Going back to my question to Mr. Fugate, how many, given the two things that I just told you, which were the practice of Nationwide Insurance Company and State Farm Insurance Company, which I think contributed to the $53.3 billion bill that our Nation paid after Hurricane Katrina, how many investigations for fraud were there, that you are aware of, where—instances of where the Nation feels like it was billed unjustly by the insurance industry?

Mr. DAVEY. I will tell you—again, I cannot speak on behalf of other carriers—

Mr. TAYLOR. Do you know of one, sir?

Mr. DAVEY. I don't know of one. I'm not aware of any.

Mr. TAYLOR. A $53 billion bill to our Nation, internal company memos that are completely contrary to the contract that these two companies have with our Nation, and you don't know of a single investigation for fraud?

Mr. DAVEY. The only company that I am responsible and should have knowledge of, is our—

Mr. TAYLOR. Okay.

Mr. DAVEY. —the companies in which I am responsible for the—

Mr. TAYLOR. Okay, just for further—

Mr. DAVEY. —operation and owner—

Mr. TAYLOR. —clarification, Mr. Davey, is it accurate to say that your adjustors were empowered to send the Federal Government a $350,000 bill, and no one from the Nation double-checked to see if that was a fair billing to our Nation?

Mr. DAVEY. Well—

Mr. TAYLOR. $250 for the—

Mr. DAVEY. —contrary to that—

Mr. TAYLOR. $250 for the—

Mr. DAVEY. They did check. We did—the NFIP did engage in audits. They came in and audited our Katrina, Rita, and Wilma claims. They went through, I don't know how—what the sample size, but in every and each claim which they examined, there was no evidence found where NFIP monies were spent on wind coverage. Every dollar we paid out through our organization went to actual flood damage.

Mr. TAYLOR. Okay.

Mr. DAVEY. I—

Mr. TAYLOR. Lastly, are any of the—and I'm glad to hear that, for those companies that you represent. I am curious how many of those companies are offering wind coverage in coastal America right now. And if you would like to name them, I would like to hear their names.

Mr. DAVEY. The Fidelity National Group were operational from Maine to the Gulf of Mexico.

Mr. TAYLOR. And have their rates increased substantially since Hurricane Katrina? By "substantially," I mean by hundreds of percent.

Mr. DAVEY. No, they have not.

Mr. TAYLOR. How much have they increased, sir?

Mr. DAVEY. I don't—it varies, State by State.

Mr. TAYLOR. Would you like to venture a guess?

Mr. DAVEY. No.

Mr. TAYLOR. You want to give me a "for instance?" How about in my State of Mississippi? How much do you think the rates have gone up?

Mr. DAVEY. I don't know.

Mr. TAYLOR. Would it be fair to say they have more than doubled, tripled, quadrupled? Is it fair to say that wind coverage for a typical property owner in the three coastal counties of Mississippi—

Mr. DAVEY. They have not doubled or tripled—

Mr. TAYLOR. —pays more for wind insurance than they do for their mortgage?

Mr. DAVEY. Wind insurance—

Mr. TAYLOR. Would you agree with that statement?

Mr. DAVEY. Wind insurance is a covered peril under the homeowner's policy. And, dependent on how susceptible the property is to wind plays a substantial role in what portion of the overall premium that covered peril represents.

Mr. TAYLOR. Okay. Last question. As far as wind coverage, what percentage of the reinsurance purchased by the companies you represent is actually coming from companies offshore in places like Bermuda? Is it half? Is it a third? Is it a quarter?

Because the question is, if homeowners can't get payment on Chinese drywall, and if homeowners couldn't get folks in Springfield, Illinois, or Hartford, Connecticut, to pay claims, how do you really expect a reinsurance company out of the Bahamas or Bermuda to pay their fair share when the time comes?

Mr. DAVEY. Well, let me first of all say that the contract of insurance that you hold with your insurance company, whether it be Fidelity National, Allstate, State Farm, is with that insurance company. And the responsibility for the fair settlement of your claim and the full payment of that claim, lies only with that carrier.

If that carrier chooses to purchase reinsurance from a highly rated entity, whether it be a U.S. reinsurer, which—our book of business, the reinsurance we purchase is split between domestic reinsurers and reinsurers around the world, all who meet our internal guideline of financial stability—believe me, we send them millions of dollars every year. We have yet to collect any meaningful sum from those carriers.

When, in fact, we make our claim, after sending them millions of dollars each and every year, they will pay us. They have been collecting our premiums, we have been paying our premiums. And when the time comes for reimbursement under that contract of insurance that—where we purchased insurance from those insurers, they will pay.

Chairwoman WATERS. Mr. Taylor, you have the last word.

Mr. TAYLOR. Thank you, ma'am.

Chairwoman WATERS. Go ahead, you have the last word.

Mr. TAYLOR. Mr. Davey, again, there were some good players after Katrina, but there were a heck of a lot of bad players. I hope you are right when it comes to reinsurance. Based on what happened after Katrina, I believe you are wrong.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

This panel is now dismissed. Before we adjourn, the written statements of the following organizations will be made a part of the record of this hearing: the Honorable Charlie Melancon; American Rivers; the National Multi Housing Council and the National Apartment Association; Property Casualty Insurers Association of America; Independent Insurance Agents and Brokers of America; the Honorable Travis Childers; the Honorable Dave Loebsack; and the Honorable Adam Putnam.

This meeting is adjourned. Thank you.

[Whereupon, at 5:03 p.m., the hearing was adjourned.]

A P P E N D I X

April 21, 2010

Congressman Travis W. Childers Opening Statement for FSC Housing Subcommittee Hearing
"Legislative Proposals to Reform the National Flood Insurance Program"
4.20.2010

Madame Chairwoman, thank you for holding this important and timely hearing to address proposals to reform the National Flood Insurance Program. Thank you also to our witnesses for taking the time to participate and share their expert views with the Subcommittee. This hearing and the subsequent markup of National Flood Insurance Program legislation is a very positive step towards a long term reauthorization of NFIP. As a veteran realtor, I understand firsthand the devastating effects that the short term extensions and lapses in NFIP have on the housing economy and homeowners. The delay and phase in of mandatory purchase requirements in newly designated Special Flood Hazard Areas, in Section 6 of the Flood Insurance Reform Priorities Act of 2010, will provide relief for homeowners and businesses as counties and municipalities implement adequate flood protection measures as determined by the Map Modernization Process. Many counties in Mississippi have been effected by Flood Map Modernization and in difficult fiscal times counties and municipalities are taking the necessary steps to protect their citizens from flooding but need the time to plan, gather resources, and complete the necessary protection. In addition, I also support today's action on my good friend, Gene Taylor's bill, the Multiple Peril Insurance Act of 2009. Hurricane Katrina devastated Mississippi and the Gulf Coast, destroying homes and businesses and leading to costly confusion with insurance policies during the re-building process. The Multiple Peril Insurance Act would give these homeowners and businesses the option of wind and flood insurance and allow affected areas to rebuild faster. The National Flood Insurance Program has many participants in the great State of Mississippi and I urge positive reform and reauthorization of the program.

Statement on National Flood Insurance Reform Legislation, Before the Subcommittee on Housing and Community Opportunity

Congressman Jerry F. Costello
Of the 12th District, State of Illinois

April 21, 2010

Chairwoman Waters, Ranking Member Capito, I appreciate the opportunity to testify before the Subcommittee today regarding legislation to reform our national flood insurance program. This important issue has received national attention in the years since Hurricane Katrina breached the levees in New Orleans and the destroyed homes along the Gulf Coast. Many aspects of flood insurance need to be examined, and I commend the Subcommittee for its dedicated attention to this work.

I am particularly concerned about the ongoing nationwide redrawing of flood maps by the Federal Emergency Management Agency (FEMA). This congressionally-mandated process is valuable part of ensuring communities understand local flood risks. However, its implementation has been arbitrary and, for some locations, opaque and confusing.

In the district I represent in the St. Louis metropolitan area, we received word from FEMA in August 2007 that due to the new flood map, the federally-built, locally-maintained levees that had protected the region for more than half a century would not be certified to meet the 100-year flood protection level. Everyone in the new map area with a federally-backed mortgage - some 30,000 homeowners, most living in economically-challenged areas - would have to purchase insurance through the national program. Quite simply, they will be hard-pressed to afford the insurance. In addition, there is no question that the regional economy will be negatively impacted by the new maps, despite the best efforts of the affected communities.

Local leaders immediately went to work assessing the necessary repairs to fix the levees. A local tax increase was approved by the state legislature to collect part of the estimated $350-500 million needed to complete the project. This work will take several years, and when the new maps go into effect, as soon as next year, the economic impact of mandatory insurance will hit the region, like the rest of the country, as it is dealing with the worst economic downturn since the Great Depression. Also, given current federal budget constraints, it is not likely that we will be able to provide significant pre-disaster assistance for the estimated $100 billion in levee repairs needed nationwide.

Concern with the remapping process is not unique to the 12th District of Illinois. Last year, I formed a working group with other House members to discuss issues related to the new flood maps, and Congressman Rodney Alexander and I formed the Congressional Levee Caucus to discuss the rebuilding and maintenance of levee systems around the country. Forty members are participating in these discussions on the impact of remapping and levee certification. While not all of them have a problem with levees, there is a common thread running through all of our meetings: local jurisdictions need time to address the impact of new maps and the costs for individuals and the local economy of mandatory insurance.

Last July, I introduced H.R. 3415, which would provide a seven-year delay in mandatory insurance purchase requirements for areas that are actively addressing the problem of fixing levees by providing funding, publishing communications and evacuation plans, and educating the public about the availability of insurance. To date, 20 members from both parties and across the country from Oregon and California to Kentucky and Tennessee have signed on as cosponsors of this bill. The interest in delaying the onset of mandatory flood insurance is an issue with broad support.

The bill introduced yesterday by Chairwoman Waters builds on the idea of delaying mandatory insurance by instituting a five-year delay of mandatory purchase requirements in any newly mapped area, and a subsequent five-year phase-in of flood insurance rates, provided the local jurisdiction has a communication and evacuation plan in place and meets insurance education requirements.

Providing a period of time for communities to adjust to the economic impacts of the mapping process gives local governments an incentive to address local needs and repairs quickly. If all we do is continue to tell communities that they have to bear the costs and burdens of remapping, I am concerned they will simply throw up their hands and either withdraw from the program altogether or wait for a disaster to hit and hope for massive federal assistance. Neither of these options brings us closer to the goal of providing long-term protection to our constituents. Allowing the flood insurance maps to take effect will achieve FEMA's goal of communicating flood risk while granting local communities the time to prepare for the economic impacts of mandatory flood insurance.

I want to thank Chairman Waters and Chairman Frank and their exceptional staffs for working with me on this issue, and Congressman Alexander for his leadership with the Congressional Levee Caucus and all of our working group members. I look forward to enacting this legislation into law and will continue to work with the Subcommittee toward that goal.

Statement of Congressman Dave Loebsack - Hearing on "Legislative Proposals to Reform the National Flood Insurance Program"

Financial Services Subcommittee on Housing and Community Opportunity

April 21, 2010

I want to thank Chairwoman Waters and Ranking Member Capito for the opportunity to provide a statement for this important hearing examining proposals to reform the National Flood Insurance Program.

I represent the 2nd Congressional District of Iowa. In the summer of 2008, the State of Iowa was devastated by severe flooding, leaving 85 of 99 counties Presidentially declared disaster areas. The majority of the damage from this flooding in the state and throughout the Midwest was in my District.

That being said, my constituents and I certainly understand and have seen firsthand the importance of the National Flood Insurance Program. It has, in fact, been helpful to hundreds of homeowners recovering from the Floods of 2008.

There are many communities in my 15-county Congressional District that are currently in various stages of FEMA's Flood Map Modernization effort. Two of these communities, one for which the process is just beginning and one for which the process has just ended, provide particularly helpful insights into issues that I hope can be addressed by the Subcommittee regarding FEMA's map modernization effort.

The first community is Louisa and Des Moines County and the City of Oakville in Iowa. The preliminary DFIRM for this area was just released in October 2009 so they are just in the beginning of the process. Already, two County Boards of Supervisors and numerous citizens have contacted my office expressing concerns about the inaccuracy of the data being used in the preliminary maps.

They have also pointed out that less accurate data is being used for the current Flood Insurance Study than was used in the previous one performed in 1991. Unfortunately, in this process, the onus to disprove the preliminary DFIRM, and the cost to do so, is on the community and affected homeowners.

The second community is the City of Cedar Rapids, Iowa. This community's final map took effect on April 5, 2010 and the preliminary DFIRM was released in December 2008.

My office was contacted by many different homeowners in three separate areas of town who had no idea the map modernization effort was even going on in their community and were only made aware of it after receiving a letter in February 2010 from the city informing them their positioning in a flood risk zone would take effect in April 2010.

While I understand that FEMA is required to place a notification in a prominent local newspaper and that the majority of the onus for notifying homeowners is on the local participating governments, surely Congress can require FEMA to do better than a one-inch box in the legal notice section of one newspaper in the community.

This notification problem could likely easily be resolved by requiring FEMA to provide notice to a prominent television or radio outlet in addition to the prominent local newspaper like they already do. I can't imagine it is too difficult to send one more legal notice than is already required. We could also examine how to encourage and assist communities to get the word out in a more efficient way.

In addition to the notification problem the City of Cedar Rapids experienced, many of these homeowners are currently appealing their status in a flood risk area which again brings up the issue of the accuracy of these maps and the onus being placed on communities and homeowners having to foot the bill to disprove the data.

I certainly believe that flood insurance is one of the most important investments a homeowner can make but also believe that homeowners should have a fair opportunity to participate in the established process of modernizing flood maps that will ultimately affect their home's value and should not have to be burdened with disproving the data that is being used.

I would also like to enter for the record a letter I am sending to FEMA and the US Army Corps of Engineers in collaboration with Congressmen Phil Hare, Sam Graves, and Blaine Luetkemeyer along with over 50 additional Members of the House, that expresses a number of concerns we have with the map modernization process and asks FEMA and the Corps to detail what steps have been taken to address these concerns.

I hope the Subcommittee will take some of these ideas and also some of the concerns expressed in this letter into account while working to reauthorize the National Flood Insurance Program.

As a Member of Congress from a state that experienced devastating flooding in both 1993 and 2008, I understand the importance of the National Flood Insurance Program for homeowners but also realize the importance of making sure FEMA gets it right.

I look forward to working with you to improve the NFIP and thank you again for this opportunity.

Sincerely,

Dave Loebsack
Member of Congress

Enclosure:

The Honorable Craig Fugate
Administrator
Federal Emergency Management Agency
500 C Street, SW
Washington, DC 20472

The Honorable Jo-Ellen Darcy
Assistant Secretary for Civil Works
U.S. Army Corps of Engineers
441 G Street, NW
Washington, DC 20314

Dear Administrator Fugate and Secretary Darcy,

As Members of Congress, we recognize that the U.S. Army Corps of Engineers (USACE) and Federal Emergency Management Agency (FEMA) have distinct but complementary roles in flood prevention and recovery at the local level. Recent hurricanes along the Gulf coast and flooding in the Midwest and Northeast regions have renewed the country's focus on preventing the loss of life and property, and FEMA is addressing the issue through the Flood Map Modernization Program. Updating our nation's Flood Insurance Rate Maps (FIRMs) is an important task and we support efforts to better inform and educate residents about flood risk in their communities. However, we are very concerned about the way USACE and FEMA have approached the process and the challenges that have been created for affected communities.

We represent a diverse population with a variety of problems that have arisen as the FIRMs have been updated. Our constituents have expressed several concerns about the flood mapping program, including:

- A lack of communication and outreach with local stakeholders;
- A lack of coordination between FEMA and USACE in answering questions about flood mapping, flood insurance and flood control infrastructure repairs;
- A lack of recognition of locally funded flood control projects when determining flood zones;
- The affordability of flood insurance;
- Inadequate time and resource to complete repairs to flood control structures before flood maps are finalized;
- Lack of consideration to extend deadlines for locally-funded flood control projects who work in good faith to make progress toward improvements;
- Limited use of LiDAR mapping as available, and the reluctance to postpone finalization of floodplain maps if LiDAR information is to be available within one calendar year of proposed deadline;
- The potential impact that new flood maps may have on economic development, particularly in small and rural communities;
- Inaccuracy of DFIRM data and the onus placed on homeowners and communities to provide accurate data; and
- Lack of coordination between FEMA and USACE on levee recertification.

Additionally, you may be aware that many of us have attempted to address these issues on multiple occasions in the past. However, the underlying problems with regard to the Flood Map Modernization Program have yet to be resolved. It is our hope that we are able to work together to find solutions to the overarching problems that our constituents are facing. If legislative solutions are called for, we would welcome your guidance.

We would also like to thank you for testifying before the House of Representatives several times over the course of the 111th Congress. Our understanding is that a bipartisan group of Senators has also recently contacted you with similar concerns. Because the annual flooding season is approaching and time is of the essence, we respectfully request a timely response to this letter indicating what actions have been completed or are currently being taken by FEMA and USACE to address the above-mentioned concerns of our constituents. If you have any questions or would like to discuss the issue with our staffs, please do not hesitate to contact us. Thank you for your attention to this matter and we look forward to hearing from you.

Sincerely,

Phil Hare	Sam Graves	David Loebsack	Blaine Luetkemeyer
Member of Congress	Member of Congress	Member of Congress	Member of Congress

Testimony of the Honorable Doris O. Matsui
Housing & Community Opportunity Subcommittee hearing: "Legislative Proposals to Reform the National Flood Insurance Program"
Wednesday, April 21, 2010 at 2:00 PM
Estimated time: 5 minutes

I thank the Chairwoman... my friend from California, Ms. Waters... & Ranking Member Capito for allowing me the opportunity to testify before the Subcommittee today.

And to thank them for scheduling consideration of the Flood Insurance Reform Priorities Act tomorrow.

This legislation, which I am pleased to cosponsor, would reform the National Flood Insurance Program (NFIP)... and contains language – H.R. 1525 – that I authored... that would provide technical changes to federal flood zone designations.

I would also like to thank Chairman Frank and Ranking Member Bachus for their continued advocacy for H.R. 1525. Both of them...and their incredible staffs...have been invaluable during this process.

Additionally, I am grateful to FEMA for collaborating with Congress to craft a number of NFIP modifications.

From my hometown of Sacramento...to the Louisiana bayou...to the plains of the Midwest...communities are improving their flood protection infrastructure in order to keep Americans safe and secure.

However, as we work to conform to changing dynamics of federal standards, these communities are seeking clarity as they work to meet Federal regulations.

Public safety is my absolute number one priority.

H.R. 1525, which was approved last summer by the House as part of the National Flood Insurance Program Extension Act,... would give communities clarity so they can continue to improve flood defenses.

Specifically, this legislation would update current law to take local, state, and federal funding into account when determining flood zone designations.

Sacramento residents and the State of California have devoted hundreds of millions of dollars toward flood protection.

It is crucial that this investment be recognized by the Federal government.

FEMA needs to identify the contributions made by the States and Cities... when they review the progress made on federal levees as they determine an area's flood designation.

For example, on one project... in the Natomas Basin... by next year the State and local governments will have spent more than $350 million over the last five years on levee improvements... WITHOUT acknowledgement from FEMA in the remapping process.

Protecting our constituents from the dangers of floods requires a comprehensive approach. Local communities...states...and the Federal government must all be thoughtful and committed partners.

With regard to another issue I would like to raise... I believe that it is equally important to note that since Hurricane Katrina... FEMA has issued new Flood Insurance Rate Maps (FIRMs) in many parts of the country.

In my district, those maps placed an area in an AE flood zone... and triggered the Federal requirement to carry flood insurance for more than 15,000 homeowners.

There is no doubt that the Natomas Basin, like most of Sacramento, is at risk of flooding... as it lays at the confluence of two major rivers.

But as I noted earlier, the Sacramento Area Flood Control Agency (SAFCA) is working with the Corps of Engineers... and the California Department of Water Resources to implement an aggressive and ambitious levee improvement plan... to achieve a 200-year level of flood protection.

While these efforts are ongoing,.. flood insurance has become mandatory... and costs homeowners more than $1,250 annually. This is nearly four times the PRP rate.

While I have always urged homeowners in floodplains to purchase flood insurance... I have serious concerns about families being forced to incur higher insurance rates during an economic recession.

Increased rates on top of the annual flood protection assessments that many residents are paying each year compounds this problem.

I am pleased that the legislation to be considered by this Committee tomorrow would phase-in rates for newly mapped areas.

This provision is a good start... but I would respectfully encourage the Committee to work with FEMA to offer reduced flood insurance premiums to those areas that have ALREADY been remapped... or implement other policies that would ensure the affordability of flood insurance rates.

In doing so, the Committee would make certain that responsible homeowners across the country... continue paying into the NFIP... without adding risk to the floodplain.

Thank you again for letting me address the Subcommittee. I look forward to continuing our ongoing efforts to improve flood protection.

I yield back my time.

STATEMENT FOR THE RECORD

THE HONORABLE ADAM H. PUTNAM

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

Legislative Proposals to Reform the National Flood Insurance Program

APRIL 21, 2010

Not since 2004, has Congress reformed and passed a long-term reauthorization of the National Flood Insurance Program (NFIP). In fact, since 2008, the NFIP has been temporarily extended five times.

Over the past several years, the NFIP has continually been placed on the Government Accountability Office (GAO) "high-risk" list of government programs, due to its vulnerabilities to fraud, waste, abuse, and mismanagement. Specifically, NFIP's existing debt of more than $18 billion from Hurricanes Katrina, Rita, and Wilma in 2005, continue to raise great concern. Due to lack of reform and financial stability, this is a debt that the NFIP is in no position to repay.

Florida is the seventh largest state in terms of flood insurance claims and according to the National Weather Service, more than one-third of the country is in danger of flooding this time of year. Given that the NFIP is already the largest single-line property insurer in the nation, providing coverage for more than five million properties, it is my hope that Congress acts to modernize and reform this Program, not grossly expand it, further exposing taxpayers to greater risk and placing the Program in greater peril.

As we continue to review proposals to reform the NFIP, it is important to note that both the non-partisan GAO and the non-partisan Congressional Research Service (CRS) have put forth policy opportunities to address the current financial and management challenges of the NFIP that are important to consider as Congress aims to reform the Program.

In a report (GAO-08-504) that analyzed the effects of combining federal flood insurance with a wind insurance program, the GAO found, among other concerns, that combing flood insurance with wind insurance would create immense challenges for the Federal Emergency Management Agency (FEMA). The report also stated that FEMA would need to overcome its solvency issues, management and oversight challenges, and ensure appropriate staff and procedures are in place prior to governing any expansion of the NFIP.

Further, CRS has suggested reforms that include a gradual phase in of actuarial rates, issuing long-term flood insurance contracts (LTFI) coupled with mitigation loans to encourage investment in risk-reduction measures, and shifting flood insurance back into the private sector.

NFIP faces a series of financial and management challenges. The future success of the NFIP will hinder on reform that includes comprehensive policies that help stabilize the long-term finances of this program, not reform that includes multiple peril insurance, further exposing a troubled Program to greater debt and risk.

I would also like to submit two letters for the record sent to Chairman Frank during the 110th Congress, highlighting concerns that Congressman Brown-Waite, Congressman Feeney and I shared regarding the inclusion of multiple peril insurance and the need to reform the NFIP, not expand it.

Congress of the United States
Washington, DC 20515

July 18, 2007

The Honorable Barney Frank
Chairman, Committee on Financial Services
US House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Frank:

We appreciate Congressman Gene Taylor's attempt to help all of those affected by nature's wrath. No one in this House wants to be as unprepared as we were for Hurricane Katrina, and as Members of the Florida delegation we recognize changes must be made in how business and homeowners are insured.

However, we have grave concerns over the haste in which the Majority is moving H.R. 920, the Multiple Peril Insurance Act. This committee has been attempting to reform the National Flood Insurance Program for several years and we still cannot agree on what measures to take. Yet H.R. 920 only received two hearings and is now being incorporated into the flood reauthorization legislation you are drafting, with Committee Members expected to vote on it before August recess. There are too many questions surrounding this measure to move this bill that quickly.

Florida's insurance problems are different from those of Mississippi and other Gulf Coast states. Our constituents have an availability and affordability problem, and our state leaders are having a hard enough problem creating an attractive market for insurers. We remain concerned over how the federal government providing wind coverage would help in those endeavors.

Our biggest concern is that Florida will be further ostracized from the national insurance market under this bill. The supporting documents provided to the committee claim that only coastal communities would have an incentive to purchase the wind and flood policy provided under H.R. 920. Drafting legislation to benefit only coastal communities does not reduce costs to policyholders. Considering the State of Florida as a whole could be considered a coastal community, this type of policy would further remove our constituents from the national insurance pool.

Moreover, we have serious concerns that H.R. 920 unfairly and inadvertently penalizes those who do not purchase a wind and flood policy from the federal government. H.R. 920 allows home and business owners to purchase wind policies only if they purchase a flood policy. Those who do not need a flood policy will either be left to the private market, and thus a smaller insurance pool with higher rates, or will be forced to purchase coverage from the federal government they do not need.

Additionally, while we appreciate that H.R. 920 requires rates to be risk-based, this causes unique problems for our constituents. Florida's sound, actuarial rates are exorbitant and have been since 2004. For this reason, the insurer of last resort, Citizen's Insurance, has absorbed the majority of Floridians, and has become one of the largest insurers in the nation. Citizen's Insurance, holding the majority of the state's risk, has had to subsidize rates by purchasing more reinsurance and borrowing up to $10 billion because Floridians cannot afford the actual cost of property and casualty insurance. Therefore, we have no reason to believe that Floridians would be able to afford a policy under H.R. 920.

Finally, we are concerned over the ramifications of this bill for all Americans. The Federal Emergency Management Administration and the NFIP are wrought with inefficiencies and controversy. The NFIP is almost $20 billion in debt, and pays $900 million per year in interest on that debt. In 2004, FEMA took up to six months to pay a claim; then in 2005, they over compensated and paid over $1 billion in wasteful, fraudulent claims. The flood maps for the NFIP are so outdated, millions of homeowners should probably be purchasing flood insurance, but they are ill advised. This was one of the biggest lessons learned in the wake of Hurricane Katrina. Members have no assurances that the same antiquated system will not prevail for wind policies under this bill. Therefore, while we appreciate that the some of the "wind vs. flood argument" may be quelled under H.R. 920, we are not confident policyholders will be better served.

Neither GAO nor CRS have provided the committee any studies on this issue; nor does industry evidence or even anecdotal evidence exist to suggest that the program under H.R. 920 would provide a better solution to Americans. Only hypothesis and suppositions are provided in the supporting documents to the committee on H.R. 920. Members have had less than six months to vet this bill with the industry, with our state regulators, and most importantly, with our constituents. We simply need more time before we are expected to make a decision on this bill.

H.R. 920 raises more concerns as opposed to offering a viable solution. Before we move any further, we urge you to allow Members, the experts, and constituents to study this issue further.

Sincerely,

Ginny Brown-Waite
Member of Congress

Tom Feeney
Member of Congress

Adam Putnam
Member of Congress

GBW:aw

CC: The Honorable Maxine Waters
The Honorable Spencer Bachus
The Honorable Judy Biggert
The Honorable Gene Taylor

Congress of the United States
Washington, DC 20515

June 9, 2008

The Honorable Barney Frank
Chairman, Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Frank:

It is our understanding that you will soon request that Speaker Pelosi appoint conferees to work out the differences between the House and Senate passed versions of H.R. 3121, the Flood Insurance Reform and Modernization Act.

As we have previously shared, we have serious concerns regarding the inclusion of multiple peril insurance in the House passed version of H.R. 3121. The implications that multiple peril insurance would have on the State of Florida are critical and we request your careful consideration that it not be included in the Conference Report for H.R. 3121

As you know, the nonpartisan Government Accountability Office (GAO) recently published a report (GAO-08-504) analyzing the effects of combining federal flood insurance with a wind insurance program. The report found, among other concerns, that combining flood insurance and wind insurance would create vast challenges for the Federal Emergency Management Agency (FEMA).

Specifically, the report cited "FEMA would need to determine wind hazard prevention standards that communities would have to adopt in order to receive coverage," as well as "adapt existing programs to accommodate wind coverage." In addition, because the process for setting flood insurance rates is different for setting wind coverage, "FEMA would need to create a new rate-setting process." FEMA would also need to overcome its solvency issues, management and oversight challenges, and ensure the appropriate staff and procedures are in place prior to governing any expansion of the National Flood Insurance Program (NFIP).

Further, the GAO maintains the NFIP's presence on its list of 2008 government programs and operations at "high risk." The program also remains in debt to the Treasury having borrowed over $17 billion to pay for events of 2005. Congress owes a duty to our constituencies to not expand this program, but to initiate the reforms that are necessary to ensure its stability and ability to effectively provide flood insurance to those that need it most.

The private market already offers wind insurance and some states even have wind pools. Adding wind coverage could make the NFIP one of the world's largest underwriters and, as a high risk program, would most likely need reinsurance. We believe this is too much uncertainty to be asking policy holders and taxpayers to subsidize.

Chairman Barney Frank
June 9, 2008
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Moreover, as we described in a letter sent to you last July, multiple peril insurance would unfairly penalize Floridian's that select to not purchase both a flood and wind policy from a federal government program. The letter stated that, "Those who do not need a flood policy will either be left to the private market, and thus a smaller insurance pool with higher rates, or will be forced to purchase coverage from the federal government they do not need."

During the 109[th] Congress the House overwhelmingly supported H.R. 4973, legislation that would reform the NFIP and that passed by a bipartisan vote of 416-4. While we support the reform of our nation's flood insurance program, we caution the serious threat posed to taxpayers through expanding the NFIP to include a wind insurance program that would dually compromise the existing program and increase its risk.

If Congress truly wants to help consumers and guarantee they receive the coverage they deserve, then we should pass legislation that would provide them with the catastrophic backstop they need without reducing consumers' insurance options and exposing the taxpayers to greater financial risk.

Sincerely,

Ginny Brown-Waite
Member of Congress

Tom Feeney
Member of Congress

Adam H. Putnam
Member of Congress

AHP:brm

Enclosure

cc: The Honorable Spencer Bachus

Opening Statement of Congressman Steve Scalise
House Committee on Financial Services
Subcommittee on Housing and Community Opportunity
Hearing on H.R. 1264, the Multiple Peril Insurance Act of 2009
April 21st, 2010

Thank you Chairwoman Waters, Ranking Member Capito, and distinguished Members of the Subcommittee.

I appreciate the opportunity to testify before your subcommittee on H.R. 1264, the Multiple Peril Insurance Act. This bi-partisan legislation has 22 cosponsors, and makes critical reforms that are important to the people of South Louisiana. By adding multiple peril coverage, which includes wind and hail, to the National Flood Insurance Program, homeowners will have greater protection against damage caused by hurricanes and other storms. Adding wind and hail coverage to the NFIP will give the people of my district the peace of mind that their homes, businesses, churches, and schools will be protected in the face of catastrophic storm damage. I commend Congressman Gene Taylor for his leadership and diligence on this issue.

I am proud to join with Congressman Taylor in championing this bill so that no American has to experience what the people of the Gulf Coast went through after Hurricane Katrina. We in South Louisiana have to live with the threat of these massive hurricanes every year, but we shouldn't have to live without protection from future storms.

As this subcommittee well knows, after Hurricane Katrina, many homeowners found themselves stranded with no payments from their insurance companies. Many homeowners were forced to sue their insurance companies in order to recoup any money from their policies. Some insurance companies overbilled the NFIP for flood damage while denying homeowners on wind damage payments. After Hurricane Katrina hit, many private insurance companies refused to write any policies that included wind coverage. Forty-six thousand people were forced into Louisiana Citizens Property Insurance

Corporation, the state's high risk pool, and Louisiana was forced to borrow $1.4 billion in order to reinsure these additional policies. Dumping policies into state insurers of last resort is not an effective or efficient solution to the need for wind insurance.

Thousands of homeowners who purchased both a wind policy as well as flood insurance found that neither policy wanted to pay even though they were covered for both. That is because if some damage was caused by wind and some caused by flood, it was up to the homeowner, in many cases, to prove whether wind or water came first. This added insult to injury for thousands of homeowners who lost everything to the storm and just wanted to get their homes repaired. Yet many had to take their insurance companies to court just to enforce the policies they had been paying premiums on for years.

This important legislation takes vital steps to implement lessons learned and prevent history from repeating itself. Our current system creates an inherent conflict of interest between private insurance companies and the federal government over who pays what when both water and wind cause damage. This legislation eliminates that conflict by providing homeowners with the option to purchase one multi-peril policy for both wind and water. No longer will homeowners be forced into state run wind pools when private insurance companies refuse to write wind coverage.

Adding wind and hail coverage to the NFIP allows us to spread the risk geographically and in a much more efficient manner. State run wind pools concentrate the risk- a large portion of those with policies through the state pool could all be affected by the same disaster, thus making it very difficult for a state run pool to build up enough reserves to pay in the event of a major disaster. This problem is not limited to the Gulf Coast alone though. Wind damage is a risk all along the coastal United States, and it is important to note that fifty-five percent of American citizens live within fifty miles of the coast. Clearly, this is an issue that affects all Americans, not just on the Gulf Coast.

I recognize that some Members may be concerned that this bill puts American taxpayers on the hook for coastal disasters. To the contrary, this legislation is designed to be actuarially sound. According to the Congressional Budget Office, the legislation would pay for itself through the premiums that would be assessed. Another important component of this bill is the addition of loss of use coverage. After Hurricane Katrina, the federal government paid out $34 billion in disaster housing assistance alone. Adding loss of use coverage would further reduce reliance on the federal government for disaster assistance in the face of catastrophic damage. This bill alleviates some of the burden on taxpayers, as opposed to adding to it by relying on disaster assistance that is often expensive and subject to fraud.

It is time to enact real reform so that homeowners have comprehensive hurricane insurance protection. Enacting reforms to NFIP will allow us to move forward with a five year extension and put an end to these short term extensions that expire when Congress fails to act. Chairwoman Waters's bill is a step in the right direction towards a full five year reauthorization, and I look forward to continuing to work towards this goal. As we approach hurricane season, enacting these reforms and passing a long term extension becomes more critical every day.

The ultimate goal of our region is to build a comprehensive hurricane protection system that allows us to look back at Katrina and say, "never again".

Again, I appreciate this opportunity to testify before the subcommittee. I would also like to thank the subcommittee for its efforts, and look forward to working with you in the future to achieve this fundamental goal.

Thank you and I yield back the balance of my time.

GENE TAYLOR
4TH DISTRICT, MISSISSIPPI

COMMITTEE ON ARMED SERVICES

CHAIRMAN
SUBCOMMITTEE ON SEAPOWER AND
EXPEDITIONARY FORCES

COMMITTEE ON TRANSPORTATION
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TESTIMONY OF
THE HONORABLE GENE TAYLOR
MEMBER OF CONGRESS,
4TH DISTRICT OF MISSISSIPPI

BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

"LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM"

APRIL 21, 2010

Thank you, Madam Chairman, for holding this hearing and for all of your assistance to me and the people of Mississippi and Louisiana since Hurricane Katrina. I know that you personally have been to the Gulf Coast at least three times to hold field hearings and to meet with local citizens, and I sincerely appreciate your efforts and support for our recovery.

As you know, the House passed a very good flood insurance reform bill in 2007 that included my legislation to create an option for coastal property owners to buy wind and flood insurance from the National Flood Insurance Program. The Housing Subcommittee under Chairman Waters and the Oversight and Investigations Subcommittee then under Mr. Watt held six hearings about the handling of Katrina insurance claims and about the need for a much better insurance option to cover hurricane losses.

Unfortunately, we were not able to convince the Senate or the Bush Administration to take the issue seriously, so the House reform package died at the end of the 110th Congress. We are back three years later. The fundamental problems in the flood program still have not been addressed and the coastal insurance crisis has spread to more states.

There are three simple reasons why coastal residents, federal taxpayers, and state governments need Congress to enact H.R. 1264, the Multiple Peril Insurance Act.

First, home owners and business owners in coastal communities need to be able to buy hurricane insurance that will cover hurricane damage without needing to hire lawyers and engineers to engage in prolonged disputes over what portion of the damage was caused by flooding and what portion was caused by wind. As long as wind and flood coverage are in separate policies, there will be gaps in coverage and disputes over causation after hurricanes.

Second, federal taxpayers need coastal home owners and business owners to pay premiums for hurricane insurance that will promptly and efficiently cover hurricane losses so that the taxpayers do not have to pay billions of dollars in rental assistance, FEMA trailers, home repair grants, subsidized loans, and tax deductions after a hurricane. Every property loss that is uninsured or for which payment is delayed or denied, ends up being subsidized in some way by federal disaster assistance.

Third, the Gulf and Atlantic states need the federal government to set up a hurricane insurance pool that will spread hurricane insurance exposure over a large geographical area to replace the state-by-state pools that concentrate the exposure in local areas. In just the past four years, insurance companies have dumped more than $300 billion in coastal insurance exposure into state-sponsored high-risk pools. These single-state pools cannot build up sufficient reserves for a major hurricane that would hit a large portion of the pool at one time.

Under the current insurance system, the National Flood Insurance Program relies on insurance companies to sell federal flood insurance policies. That is a good idea because then we do not need to hire federal insurance agents. However, GAO has found that NFIP overpays insurance companies by hundreds of millions of dollars in administrative subsidies. Congress should enact all ten GAO recommendations to reduce the administrative payments and to improve the oversight and accountability of the operating subsidies paid to the Write Your Own companies.[1]

Unfortunately, that is the least of NFIP's problems caused by its failure to provide adequate oversight of the insurance companies. The flood program also allows the insurance companies to adjust flood claims after a hurricane and determine how much damage to blame on flooding and bill to the federal taxpayers and how much damage to blame on wind that is covered by the insurers' own policies. GAO correctly described this arrangement as an "inherent conflict of interest."[2]

[1] U.S. Government Accountability Office (GAO), *Flood Insurance: Opportunities Exist to Improve Oversight of the WYO Program*, GAO-09-455 (Washington, D.C.: August 2009).
[2] GAO, *National Flood Insurance Program: Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed*, GAO-08-28 (Washington, D.C.: December 2007).

GAO also found that FEMA did not require the insurance companies to explain their procedures for identifying, apportioning, or quantifying the damages caused by flood or wind on properties that experienced both perils. GAO recommended that Congress give FEMA clear statutory access to the wind claims files for properties with both wind and flood damage, and require the insurance companies to document their procedures for adjusting cases where both perils contributed to the damage.[3]

I urge Congress and the Administration to enact the GAO recommendations but I do not believe that they go far enough. The "inherent conflict of interest" that insurance companies have under the current system cannot be managed or mitigated.

In fact, the GAO report barely scratched the surface of the many ways that insurance companies shifted their liabilities to the federal taxpayers. Several of the largest insurers in the country implemented an extreme interpretation of their "Anti-Concurrent Causation" clauses, attempting to deny any coverage of wind damage if flooding also contributed to the damage later.

Two weeks after Katrina, State Farm sent a memo to its adjusters with the instruction that "Where wind acts concurrently with flooding to cause damage to the insured property, coverage for the loss exists only under flood coverage."[4]

State Farm's adjusters spent the first month after the storm driving around South Mississippi handing out flood insurance checks from federal taxpayers, but made no attempt to determine the amount of wind damage or to prove the amount of flood damage. When State Farm did send engineers to estimate the cause of damage at some of those properties, the engineers were given instructions that they not divide the loss between wind and flood, and coerced and threatened them to blame it all on flooding.

These tactics and actions have been exposed in case after case after case in the past four years, but NFIP, FEMA, the Department of Homeland Security, and the Department of Justice have done nothing to step up and protect policyholders and taxpayers.

Although the interpretation of Anti-Concurrent Causation language was the central legal issue in thousands of cases, it took four years of delays, appeals, and settlements, before we finally received a definitive legal interpretation by the Mississippi Supreme Court. In *Corban v. USAA*, the state Supreme Court ruled that damage caused by wind before any flood damage should be covered by the wind insurance policy, not by the flood insurance policy. The Court also confirmed that the insurance company has the burden to prove that the loss is excluded or else pay the claim.

During oral arguments in the *Corban* case, Nationwide was permitted to appear as an interested party. Nationwide's attorney, Christopher Landau, argued that the sequence

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[3] GAO, *National Flood Insurance Program: Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed,* GAO-08-28 (Washington, D.C.: December 2007).
[4] *Wind/Water Claim Handling Protocol* memorandum to State Farm Claim Associates handling CAT PL in the Central and Southern Zones from Property and Casualty Claim Consulting Services, September 13, 2005.

of the wind and flood damage did not matter because of the Anti-Concurrent Causation clause.

Mississippi Supreme Court Justice Randy "Bubba" Pierce had this exchange with Landau:[5]

> JUSTICE PIERCE: So you're sequencing, if 95 percent of the home was destroyed, and then we have the event of the storm surge, then you would not pay a dime?
>
> MR. LANDAU: Your Honor, if we prove that the storm surge was sufficient to cause - we have that burden, again, and that is absolutely crystal clear.
>
> If we can prove that the storm surge was sufficient to cause all of this, it is no answer then to say, 'Yeah, but I'm going to show it -- I'm going to have somebody come in and say, "Look, guess what, the window was broken before the storm surge came and then wiped away the whole house.
>
> But you don't get into those kinds of issues precisely because of the sequencing of the damage.
>
> JUSTICE PIERCE: So you wouldn't pay a dime?
>
> MR. LANDAU: If - again, we wouldn't pay a dime for things where we can carry our burden, which is right there in the policy, of showing that the loss was caused concurrently –
>
> JUSTICE PIERCE: I'm giving you -- the example is 95 percent of the home is destroyed, the flood comes in and gets the other five percent, and you know that.
>
> Does your interpretation of the word "sequence" mean you pay zero?
>
> MR. LANDAU: Yes, your Honor.

It took four years to officially reject that ridiculous argument and get a common sense interpretation of the most important point of law because the insurance companies were able to move the thousands of cases to federal court and then bog down those courts with motions about anything and everything except the facts and the law central to the cases. Whenever it appeared that a case might come to trial and provide a useful precedent for other cases, the defendant insurance company would settle it confidentially.

While I have great respect and admiration for Judge L.T. Senter, Jr., who has spent the past four and half years dealing with many of these cases in South Mississippi, the fact is that the federal court system failed after Katrina. The insurance companies have been allowed to carry out an obvious legal strategy whose goal was to delay disaster victims their day in court in order to wear them down so they would accept settlement offers.

Many of the people who were denied coverage eventually reached settlements with their insurance companies, but the years of denials and delays were very costly to the federal

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[5] Oral Arguments before the Mississippi Supreme Court, *Corban v. USAA.*

taxpayers. Congress and the federal government did not sit idly by while hundreds of thousands of citizens were left homeless by Hurricane Katrina.

While many people have commented about the fact that the National Flood Insurance Program paid more than $16 billion in claims from Hurricane Katrina, almost no one has noted the fact that the federal government spent more than twice that much, 34.5 billion dollars, providing rental assistance, FEMA trailers, grants, and loans for home repairs.

Federal Disaster Housing Assistance to Residents Displaced by Katrina

FEMA Housing Assistance Payments[6]	**$4,287,388,698**
FEMA Manufactured Housing Costs[7]	**$7,172,714,484**
HUD CDBG Housing Grants[8]	**$15,437,876,000**
SBA Disaster Home Loans[9]	**$7,610,787,000**
TOTAL HOUSING ASSISTANCE	**$34,508,766,182**

A significant part of those costs should have been paid by insurance or could have been avoided if residents had insurance policies that would have covered their hurricane losses without disputes or gaps in coverage.

Homeowners insurance policies generally have coverage for "loss of use" or "additional living expenses" that will provide some amount of temporary living expenses if a policyholder is displaced because of a covered loss. When the insurance companies denied wind coverage, the denial also precluded coverage of living expenses. The flood insurance program does not provide coverage for loss of use or business interruption. Those coverages should be added to NFIP.

With many people displaced by Hurricane Katrina, FEMA immediately provided $2,000 per household. Because of the scope and severity of the property losses from Katrina, FEMA housing assistance grew into a long-term rental assistance program that ended up costing almost $4.3 billion.

In mid-September of 2005, President Bush came to New Orleans and announced that the federal government would provide a trailer to anyone who lost their home from Katrina. FEMA eventually paid more than $7 billion to provide 140,000 trailers. Many of the 42,000 trailers in Mississippi provided temporary housing for residents whose insurance claims had been denied and were waiting for their day in court.

[6] FEMA, *Disaster Relief Fund: Monthly Status Report, Fiscal Year 2010 Report to Congress,* March 15, 2010.
[7] *ibid.*
[8] GAO, *Gulf Coast Disaster Recovery: Community Development Block Grant Program Guidance to States Needs to Be Improved,* GAO-09-541 (Washington, D.C.: June 2009).
[9] Bruce R. Lindsay, Congressional Research Service, unpublished data from SBA

In the meantime, many homeowners who had uninsured or insured-but-unpaid losses, took out low-interest disaster loans from SBA to repair or rebuild their homes. SBA made more than 100,000 disaster home loans for a total of $7.6 billion in Louisiana, Mississippi, and Alabama.

In the December 2005 Supplemental Appropriations Act, Senator Thad Cochran of Mississippi helped get the first appropriation for the Community Development Block Grant funds that would become the Road Home Program in Louisiana and the Homeowner Assistance Grant program in Mississippi. The concept for that program originated in the House Financial Services Committee with then-Ranking Member Barney Frank and his staff helping me draft a bill to provide assistance for the thousands of people whose homes flooded but who did not have flood insurance at least in part because they were not in a Special Flood Hazard Area according to the flood insurance maps.

Our bill would have paid disaster assistance to these homeowners through the National Flood Insurance Program in exchange for a covenant attached to the deed requiring flood insurance in perpetuity. Our proposal was opposed by the Bush Administration and Republican House leaders, but Senator Cochran was able add CDBG funds so that the states could create their own housing assistance programs.

While both states obligated residents to purchase flood insurance as a condition of the grants, I am concerned that neither the states nor the NFIP are actively enforcing the requirement.

In Mississippi, Phase I of the Homeowners Grant awards were based on the amount of uninsured loss, but capped at the amount of homeowners insurance in force at the time of Katrina. This was designed to assist homeowners who believed that they had insured their properties for a hurricane. However, this program served to take a lot of the pressure off of the insurance companies to pay on their wind claims.

The Road Home Program in Louisiana was a larger program with different criteria, but it also relieved a lot of pressure on the insurance companies by proving grants for uninsured or unpaid losses of people who did not collect in full on their insurance policies. Overall, the CDBG grant programs provided more than $15.4 billion in housing assistance grants, almost as much as the total of flood insurance claims payments.

Those four programs, rental assistance, FEMA trailers, SBA loans, and CDBG grants total more than $34.5 billion in direct assistance to homeowners and displaced renters. There also were billions of dollars of casualty loss tax deductions and other tax relief for homeowners. In additions, FEMA has provided billions of dollars of assistance to local governments and Congress has waived the local cost-shares and provided for the forgiveness of Community Disaster Loans because the property tax base still has not recovered. A large portion of those federal costs are the direct result of the gaps in insurance coverage.

The spokesmen for the insurance industry defend its performance by saying that insurers paid more than $41 billion in claims from Katrina. What they rarely admit is that the majority of the money was paid on large commercial claims, including some big business interruption claims because the oil and gas industry was shut down for a few weeks. It is great that those businesses were paid, but those claims are irrelevant to the discussion about the handling of homeowners wind and flood claims. The itemization of the insurance claims payments and federal assistance in Mississippi shows that the aggregate numbers are very misleading.

Payment Source	Number	Total Payments	Average
NFIP Claims Paid[10]	17,464	$2,439,649,984	$139,696
CDBG Homeowner Grants[11]	27,741	$2,158,364,059	$77,804
SBA Disaster Home Loans[12]	31,243	$2,069,160,000	$66,228
FEMA Trailers[13]	42,000	$1,596,628,569	$38,015
Homeowners Claims[14]	355,000	$5,475,000,000	$15,423

Insurance companies paid billions of dollars in homeowners claims, but the average claim in Mississippi was a little over $15,000, not even half the federal government's cost to provide a FEMA trailer. Katrina was a very large hurricane with high winds that caused property damage over a large multi-state area. Insurance companies paid Katrina homeowners claims in all 82 counties in Mississippi, all over Louisiana and Alabama, and in parts of Florida, Georgia, and Tennessee. Insurers paid 40,000 claims in the Jackson Metro area, 150 miles north of the Gulf of Mexico. Yet in the relatively narrow area along the Gulf, where the hurricane winds were much stronger and for a longer period of time, some insurance companies insisted that the winds had not been strong enough to cause more than superficial damage. There were very few lawsuits against insurance companies inland where there was no flooding. The problems were along the Coast where properties suffered both wind and flood damage.

Mississippi accounted for 17,464 of the 166,973 NFIP claims paid on Hurricane Katrina flooding; only 10.4% of the claims, but those claims accounted for 15.5% of the payments, because almost every NFIP claim in Mississippi was a total loss. There are several reasons why the average NFIP claim in Mississippi was almost $140,000.

[10] FEMA, *Disaster Relief Fund: Monthly Status Report, Fiscal Year 2010 Report to Congress,* March 15, 2010.
[11] Mississippi Development Authority, unpublished data, April 16, 2010.
[12] Bruce R. Lindsay, Congressional Research Service, unpublished data from SBA
[13] FEMA, *Disaster Relief Fund: Monthly Status Report, Fiscal Year 2010 Report to Congress,* March 15, 2010.
[14] Robert Hartwig, Insurance Information Institute, *Catastrophes, the Credit Crisis & Insurance Cycle,* Ole Miss Insurance Symposium, March 26, 2008.

The first reason, of course, is that Katrina's storm surge was unprecedented in height and scope. The surge was more than 30 feet above sea level in Bay St. Louis, Waveland, and Pass Christian, but still more than 20 feet above sea level in Pascagoula, 60 miles east of the eye of the storm. The storm surge caused severe damage to the homes near the Gulf of Mexico that were 20 feet or less above sea level. Those homes also experienced several hours of high hurricane-force winds before the storm surge, so they should have been able to collect on both policies.

The second reason that the Mississippi NFIP claims payments were so high was the lack of adequate oversight of the insurance companies handling of the claims. There were thousands of NFIP policies on homes that were located on the bays, bayous, and rivers near the Gulf. Those properties flooded but the flood levels were not as high and did not have the force of the storm surge on the Gulf. Many of these cases had roof and structural damage from wind and wind-driven debris and also several feet of flooding. More importantly, they also had enough physical evidence remaining for a proper adjustment of the losses from wind and flooding.

Some of these cases have been the subject of prolonged legal disputes, and in almost every one that has become public, the insurance company immediately paid the policy limits on the flood policy without a detailed adjustment and then used the acceptance of the flood check against the homeowners when they tried to collect on the wind claim. It is almost certain that NFIP overpaid on dozens if not hundreds of these flood claims, but as GAO pointed out, FEMA did not ask the insurance companies to explain how they divided the wind loss from the flood loss.

The third reason that the Mississippi NFIP claims average was so high was because the flood insurance maps were horrible. The flood maps at the time of Katrina estimated that the 100-year flood on the Mississippi Gulf Coast was 12 or 13 feet above sea level. As a result, many homeowners whose homes were 16, 18, 20, or more feet above sea level were led to believe that they did not need flood insurance. Thousands of homes from several blocks to several miles inland had a few feet of flooding resulting in $25,000 or $50,000 or $75,000 in reparable losses, but did not have flood insurance. Those properties accounted for most of the CDBG Homeowners Grants, which had an average grant of $77,800.

The Flood Insurance Rate Maps in Mississippi were not storm surge maps. Back in October of 2005, the first time I testified about Katrina in this subcommittee, I came with posters to show the difference between the flood insurance map, which showed that very little of City of Gulfport in the flood hazard area, and the evacuation map based on data from NOAA and the Corps of Engineers, which identified many more flood-prone areas. If the flood insurance map had been based on the same data as the evacuation map, many more people would have had flood insurance coverage and would have paid premiums, and many more homes would have been elevated a few feet off the ground and had less damage.

There is one simple reform that would make sure that more future hurricane damage will be covered by insurance premiums and less disaster assistance would be needed from the federal government. That reform is our legislation, H.R. 1264, to offer wind coverage as option with federal flood insurance. The program would close the gaps and uncertainties in hurricane coverage. It would eliminate the insurance companies' conflict of interest when handling hurricane flood claims. It would make future recoveries much faster and more efficient for homeowners, communities, and for federal taxpayers.

Since Katrina, insurance companies have abandoned coastal communities, creating an urgent insurance crisis along the Gulf Coast and Atlantic. State-sponsored high-risk pools have billions of dollars of hurricane exposure but are not able to build up enough reserves to cover a major hurricane that would result in a large volume of claims at one time.

Four Year Increase in Insurance Exposure in Selected State Insurance Pools

State Risk Pool	Dec 2004 Exposure	Dec 2008 Exposure	Change
Florida Citizens[15]	**$202.8 Billion**	**$436.8 Billion**	**+115%**
North Carolina Beach Plan[16]	**$31.6 Billion**	**$73.5 Billion**	**+132%**
Texas Wind Pool[17]	**$20.8 Billion**	**$58.6 Billion**	**+182%**
South Carolina Wind Pool[18]	**$6 Billion**	**$17 Billion**	**+184%**
Mississippi Wind Pool[19]	**$1.6 Billion**	**$6.3 Billion**	**+283%**
Alabama Beach Pool[20]	**$337 Million**	**$1.8 Billion**	**+448%**
Georgia FAIR Plan Wind[21]	**$565 Million**	**$2.1 Billion**	**+265%**

The insurance industry has fled and they will not come back. If some of them do come back to coastal markets, history has shown that they will flee again after the next major disaster. Some insurance executives have admitted that the private insurance model will not work for low-frequency, high-severity events, such as major floods, major hurricanes, or major earthquakes.

Research by Dr. Howard Kunreuther and Dr. Erwann Michel-Kerjan at the Wharton Risk Management Center at the University of Pennsylvania found that catastrophe insurance premiums in the highest risk areas can be five to ten times higher than the expected claims losses.[22]

Other researchers have also found that insurance premiums in coastal areas are several times higher than the claims they expect to pay. The reason they have to charge such

[15] https://www.citizensfla.com/
[16] http://www.ncjua-nciua.org/html/fin.htm
[17] http://www.twia.org/AboutTWIA/PublicFinancialInformation.aspx
[18] http://www.scwind.com/members2.htm
[19] http://www.msplans.com/MWUA/Index.htm
[20] https://www.alabamabeachpool.org/pages/quarterly_reports
[21] http://www.georgiaunderwriting.com/index_files/Page345.htm
[22] Howard Kunreuther and Erwann Michel-Kerjan, *Managing Large-Scale Risks in a New Era of Catastrophes*, Wharton Risk Management Center, University of Pennsylvania, 2008. p. 141.

high premiums is that every year they have to account for the large amount of capital that would be needed if a major hurricane hits. In order to acquire or account for that much money, they have to pay high returns each year to attract capital investors or they have to buy reinsurance from reinsurance companies that pay high returns each year to attract capital investors. In either case, most of the resulting insurance premiums go to pay investors, not to pay future insurance claims.

Economist Lloyd Dixon of the RAND Corporation has explained the advantage of a government insurance program in high-risk areas:

> *"Government is not subject to the private-sector factors that produce large swings in premiums around expected loss in private insurance markets. Thus, compared with the private sector, government should be able to set insurance prices closer to expected loss for hurricanes and other catastrophic risks, and keep those prices closer to expected loss over time.*[23]

The federal government should be able to establish a hurricane insurance program that would spread risk geographically along the Gulf and Atlantic states. The federal program would be able to set rates based on the risk and create a stable insurance market. It would be very easy for the new program to determine wind risk and set wind premiums, because the state governments, the building industry, and the insurance industry have already done most of the work for them. For example, this is how the Mississippi Wind Pool sets its rates.

The Mississippi Wind Pool is the wind insurer of last resort for the three counties on the Gulf of Mexico and the three counties directly above those. The wind pool divides the territory into four rate zones:

Zone A – Between the Gulf of Mexico and the CSX Railroad
Zone B – Between the CSX Railroad and Interstate-10
Zone C – From I-10 north to the county lines
Zone D – The second tier of counties above the coastal counties

Within each zone, the wind pool board establishes risk-based rates for frame construction and masonry construction with several policy options for higher or lower deductibles. The wind pool also has a program that grants premium reductions for structures that meet a high wind-load mitigation standard.

The zones, the rates, and the mitigation credits are based on plenty of available data from the American Society of Civil Engineers, the International Code Council, and many other interested parties who study wind risk and building performance.

[23] Lloyd Dixon, James Macdonald, and Julie Zissimopoulos, *Coastal Wind Insurance in the Gulf States*, RAND Gulf States Policy Institute, 2007, p. 8.

Other states with wind pools have established wind risk zones in similar manner, often using any easily identifiable and unambiguous feature to divide the zones. The Texas wind pool uses the Intracoastal Canal to divide the highest risk zone from the second zone.

Wind risk is much easier to determine and to map than is flood risk. The probability and severity of hurricane winds is much more predictable than the storm surge or the amount of rainfall, and the wind risk does not constantly change with any change in topography as flood risk does. Also, of course, wind insurance does not have to make assumptions about the performance of levees, dams, pumps, or other flood control structures.

The only problem that we would have setting up the new Multiple Peril Insurance Program would be dealing with the existing problems of NFIP: the oversight and management deficiencies, the inaccuracy of many of the flood maps, the poor record of the flood plain management, and the failure of the Write Your Own companies to honor their fiduciary responsibility to the federal government. The main source of all of these problems is that the NFIP and FEMA have proven the textbook case of just how inefficient a program can be if it is handed over to the contractors, vendors, and insurance companies who have conflicts of interest yet are allowed to obligate federal tax dollars with little federal government oversight.

I urge Congress to pass the Multiple Peril Insurance Act and when it passes I urge FEMA and NFIP to hire qualified, professional federal employees who will be accountable to the taxpayers to setup and manage the program. Please do not run it in the same manner as the current flood program.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

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NATIONAL FLOOD INSURANCE PROGRAM

Continued Actions Needed to Address Financial and Operational Issues

Statement of Orice Williams Brown, Director
Financial Markets and Community Investment

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GAO-10-631T

April 21, 2010

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Highlights

Highlights of GAO-10-631T, a testimony before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

NATIONAL FLOOD INSURANCE PROGRAM

Continued Actions Needed to Address Financial and Operational Issues

Why GAO Did This Study

The National Flood Insurance Program (NFIP), established in 1968, provides policyholders with insurance coverage for flood damage. The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security is responsible for managing NFIP. Unprecedented losses from the 2005 hurricane season and NFIP's periodic need to borrow from the U.S. Treasury to pay flood insurance claims have raised concerns about the program's long-term financial solvency. Because of these concerns and NFIP's operational issues, NFIP has been on GAO's high-risk list since March 2006. As of April 2010, NFIP's debt to Treasury stood at $18.8 billion.

The Subcommittee asked GAO to discuss (1) NFIP's financial challenges, (2) FEMA's operational and management challenges, and (3) actions needed to address these challenges. In preparing this statement, GAO relied on its past work on NFIP and GAO's ongoing review of FEMA's management of NFIP focused on information technology and contractor oversight issues.

What GAO Recommends

In past work, GAO recommended, among other things, that FEMA take steps to help ensure that premium rates are more reflective of flood risks; strengthen its oversight of NFIP and insurance companies responsible for selling and servicing flood policies; and strengthen its internal controls and the quality of its data.

View GAO-10-631T or key components. For more information, contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov.

What GAO Found

While Congress and FEMA intended that NFIP be funded with premiums collected from policyholders rather than with tax dollars, the program is, by design, not actuarially sound. NFIP cannot do some of the things that private insurers do to manage their risks. For example, NFIP is not structured to build a capital surplus, is likely unable to purchase reinsurance to cover catastrophic losses, cannot reject high-risk applicants, and is subject to statutory limits on rate increases. In addition, its premium rates do not reflect actual flood risk. For example, nearly one in four property owners pay subsidized rates, "full-risk" rates may not reflect the full risk of flooding, and NFIP allows "grandfathered" rates, which allow some property owners to continue paying rates that do not reflect reassessments of their properties' flood risk. Further, NFIP cannot deny insurance on the basis of frequent losses and thus provides policies for repetitive loss properties, which represent only 1 percent of policies but account for 25 to 30 percent of claims. NFIP's financial condition has improved slightly due to an increase in the number of policyholders and moderate flood losses, and since March 2009, FEMA has taken some encouraging steps toward improving its financial position, including making $600 million in interest payments to Treasury without increasing its borrowings. However, it is unlikely to pay off its full $18.8 billion debt, especially if it faces catastrophic loss years.

Operational and management issues may also limit efforts to address NFIP's financial challenges and meet program goals. Payments to write-your-own (WYO) insurers, which are key to NFIP operations, represent one-third to two-thirds of the premiums collected. But FEMA does not systematically consider actual flood insurance expense information when calculating these payments and has not aligned its WYO bonus structure with NFIP goals or implemented all of its financial controls for the WYO program. GAO also found that FEMA did not consistently follow its procedures for monitoring non-WYO contractors or coordinate contract monitoring responsibilities among departments on some contracts. Some contract monitoring records were missing, and no system was in place that would allow departments to share information on contractor deficiencies. In ongoing GAO work examining FEMA's management of NFIP, some similar issues are emerging. For example, FEMA still lacks an effective system to manage flood insurance policy and claims data, despite investing roughly 7 years and $40 million on a new system whose development has been halted. However, FEMA has begun to acknowledge its management challenges and develop a plan of action.

Addressing the financial challenges facing NFIP would likely require actions by both FEMA and Congress that involve trade-offs, and the challenges could be difficult to remedy. For example, reducing subsidies could increase collected premiums but reduce program participation. At the same time, FEMA must address its operational and management issues. GAO has recommended a number of actions that FEMA could take to improve NFIP operations, and ongoing work will likely identify additional issues.

Chairwoman Waters, Ranking Member Capito, and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program (NFIP) and the challenges that the Federal Emergency Management Administration (FEMA) faces in administering it. As you know, NFIP is a key component of the federal government's efforts to minimize the damage and financial impact of floods and is the only source of insurance against flood damage for most residents in flood-prone areas. GAO placed NFIP on its high-risk list in March 2006, not only because of the program's potential to incur billions of dollars in losses and the many financial challenges it faces, but also because of operational and management challenges within FEMA, many of which we have identified in previous reports to Congress.

As of April 2010, NFIP owed approximately $18.8 billion to the U.S. Treasury, primarily as a result of loans the program received to pay claims from the 2005 hurricane season. NFIP borrowed additional funds from Treasury to make interest payments on this debt and is unlikely ever to be able to repay the entire amount. These revenue shortfalls reflect both the devastating effects of catastrophic hurricanes and structural weaknesses in the way the program is funded. Our previous reports identified many of these weaknesses, including subsidized premium rates, rate-setting methods that do not reflect the actual risk of losses due to flooding, and claims arising from a small number of repetitive loss properties.[1] We have also previously identified management issues, particularly with respect to FEMA's oversight of write-your-own (WYO) insurers. We are currently conducting a comprehensive review of NFIP management and other ongoing challenges that FEMA faces in administering the program.

My testimony today will revisit and update the challenges we identified in previous reports, specifically (1) NFIP's financial challenges, (2) FEMA's operational and management challenges relating to NFIP, and (3) actions needed to address these challenges. My statement is based largely on completed work on the oversight of the WYO program, the financial impact of subsidized premium rates, and the rate-setting process for flood insurance premiums. We performed our work in accordance with generally accepted government auditing standards. Those standards

[1]Repetitive loss properties are properties that have had two or more paid NFIP claims in a 10-year period.

require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Congress and FEMA intended that the NFIP's operating expenses and flood insurance claims would be paid with premiums collected by the program rather than with tax dollars. But the program is, by design, not actuarially sound, for several reasons. First, NFIP does not operate like private insurance companies. For example, FEMA is not structured to build a capital surplus, is likely unable to purchase reinsurance to cover high or catastrophic losses, cannot accept or reject applicants to help manage risk, and is subject to statutory limits on rate increases. Second, many property owners are paying premium rates that do not reflect the full, long-term risk of flooding. Almost 25 percent of property owners pay subsidized premium rates, and even "full-risk" premium rates may not reflect the actual risk of flooding. Further NFIP allows some property owners to continue to pay rates that do not reflect reassessments of their properties' flood risk ("grandfathered" rates). Finally, NFIP must continue to insure repetitive loss properties, which represent only 1 percent of flood insurance policies but account for 25 to 30 percent of claims. FEMA has taken some encouraging steps toward improving its financial position, including making nearly $600 million in interest payments to the U.S. Treasury since March 2009 without increasing its borrowing. It has also increased its collected premiums by 28 percent since September 2006 and expanded its policy base by more than 25 percent, due at least in part to its FloodSmart program.[2]

Several operational and management issues may limit FEMA's progress in addressing NFIP's financial challenges and achieving the program's goals. For example, WYO insurers play a key role in NFIP operations, and payments to them represent from one-third to two-thirds of premiums received. But in previous reports we found that, among other internal control weaknesses, FEMA did not systematically consider actual flood insurance expense information when determining payments to WYO insurers, had not aligned its WYO bonus structure with NFIP's goals, and

[2]FloodSmart is an integrated mass marketing campaign FEMA launched in 2004 to educate the public about the risks of flooding and to encourage the purchase of flood insurance.

had not implemented many of its planned financial controls for the WYO program.[3] Further, contractors other than WYO insurers are responsible for performing key NFIP functions, such as collecting NFIP data and marketing the program. However, we have also found problems with oversight of these contractors. Specifically, FEMA did not consistently follow its procedures for monitoring contractors, did not always coordinate contract monitoring responsibilities among various agency departments on some of the contracts we reviewed, lacked contract monitoring records, and did not have a system in place that would allow various departments to share information relating to contractor deficiencies. Further, preliminary results of our ongoing work revealed that FEMA continues to lack an effective system to manage flood insurance policy and claims data, despite having invested roughly 7 years and $40 million in a new system whose development has been halted because it did not meet user needs and was not ready to replace the legacy system.

Addressing the financial and operational challenges facing NFIP would require actions from both Congress and FEMA. We recognize that any such actions would involve significant trade-offs and that some financial challenges would be difficult to remedy. For instance, possible reform options to make premium rates more reflective of long-term flood risks include eliminating, reducing, or targeting premium subsidies based on need. But taking any of these steps would raise rates and potentially reduce participation in NFIP. FEMA and Congress could also address the impact of repetitive loss properties by expanding mitigation efforts to target those properties that are at highest risk.[4] However, doing so would include actions such as elevation, relocation, and demolition that would be costly to taxpayers and could take years. Congress could also amend laws regarding coverage for homeowners who refuse to mitigate and streamline the various mitigation grant programs within FEMA. In our past work, we also identified a number of management challenges that FEMA would have to address, including improvements to oversight of WYO insurers and its payments to them, updating the NFIP rate-setting process, fully applying internal controls, and strengthening oversight of its contractors, among others.

[3]See GAO, *Flood Insurance: Opportunities Exist to Improve Oversight of the WYO Program*, GAO-09-455 (Washington, D.C.: Aug. 21, 2009).

[4]Mitigation involves taking steps to reduce a property's flood risk—for example, elevating a house above a certain flood level.

Background

The National Flood Insurance Act of 1968 established NFIP as an alternative to providing direct disaster assistance after floods.[5] NFIP, which provides government-guaranteed flood insurance to homeowners and businesses, was intended to reduce the federal government's escalating costs for repairing flood damage after disasters. FEMA, which is within the Department of Homeland Security (DHS), is responsible for the oversight and management of NFIP. Since the program's inception, Congress has enacted several pieces of legislation to strengthen it. The Flood Disaster Protection Act of 1973 made flood insurance mandatory for owners of properties in vulnerable areas who had mortgages from federally regulated lenders and provided additional incentives for communities to join the program.[6] The National Flood Insurance Reform Act of 1994 strengthened the mandatory purchase requirements for owners of properties located in special flood hazard areas (SFHA) with mortgages from federally regulated lenders.[7] Finally, the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 authorized grant programs to mitigate properties that experienced repetitive flood losses. Owners of these repetitive loss properties who do not mitigate face higher premiums.[8]

To participate in NFIP, communities agree to enforce regulations for land use and new construction in high-risk flood zones and to adopt and enforce state and community floodplain management regulations to reduce future flood damage. Currently, more than 20,000 communities participate in NFIP. NFIP has mapped flood risks across the country, assigning flood zone designations based on risk levels, and these designations are a factor in determining premium rates. NFIP offers two types of flood insurance premiums: subsidized and full-risk. The National Flood Insurance Act of 1968 authorizes NFIP to offer subsidized premiums to owners of certain properties. These subsidized premium rates, which represent only about 35 to 40 percent of the cost of covering the full risk of flood damage to the properties, account for about 22 percent of all NFIP policies. To help reduce or eliminate the long-term risk of flood damage to buildings and other structures insured by NFIP, FEMA has used a variety of mitigation efforts, such as elevation, relocation, and demolition. Despite

[5]Pub. L. No. 90-448, Title XIII, 82 Stat. 476 (1968).

[6]Pub. L. No. 93-234, § 102, 87 Stat. 975, 978 (1973).

[7]Pub. L. No. 103-325, 108 Stat. 2255 (1994).

[8]Pub. L. No. 108-264, §§ 102, 104, 118 Stat. 712, 714, 722 (2004).

these efforts, the inventories of repetitive loss properties and policies with subsidized premium rates have continued to grow. In response to the magnitude and severity of the losses from the 2005 hurricanes, Congress increased NFIP's borrowing authority from the Department of the Treasury (Treasury) to $20.775 billion. As of April 2010, FEMA owed Treasury $18.8 billion, and the program as currently designed will likely not generate sufficient revenues to repay this debt.

NFIP's Financial Challenges Have Increased the Federal Government's and U.S. Taxpayers' Financial Exposure from Flood Losses

By design, NFIP is not an actuarially sound program, in part because it does not operate like many private insurance companies. As a government program, its primary public policy goal is to provide flood insurance in flood-prone areas to property owners who otherwise would not be able to obtain it. Yet NFIP is also expected to cover its claims losses and operating expenses with the premiums it collects, much like a private insurer. In years when flooding has not been catastrophic, NFIP has generally managed to meet these competing goals. In years of catastrophic flooding, however, and especially during the 2005 hurricane season, it has not.

NFIP's operations differ from those of most private insurers in a number of ways. First, it operates on a cash-flow basis and has the authority to borrow from Treasury. As of April 2010, NFIP owed approximately $18.8 billion to Treasury, primarily as a result of loans that the program received to pay claims from the 2005 hurricane season. NFIP will likely not be able to meet its interest payments in most years, and the debt may continue to grow as the program may need to borrow to meet the interest payments and potential future flood losses. Also unlike private insurance companies, NFIP assumes all the risk for the policies it sells. Private insurers typically retain only part of the risk that they accept from policyholders, ceding a portion of the risk to reinsurers (insurance for insurers). This mechanism is particularly important in the case of insurance for catastrophic events, because the availability of reinsurance allows an insurer to limit the possibility that it will experience losses beyond its ability to pay. NFIP's lack of reinsurance, combined with the lack of structure to build a capital surplus, transfers much of the financial risk of flooding to Treasury and ultimately the taxpayer.

NFIP is also required to accept virtually all applications for insurance, unlike private insurers, which may reject applicants for a variety of reasons. For example, FEMA cannot deny insurance on the basis of frequent losses. As a result, NFIP is less able to offset the effects of adverse selection—that is, the phenomenon that those who are most likely to purchase insurance are also the most likely to experience losses. Adverse selection may lead to a concentration of policyholders in the riskiest areas. This problem is further compounded by the fact that those at greatest risk are required to purchase NFIP insurance if they have a mortgage from a federally regulated lender. Finally, by law, FEMA is prevented from raising rates on each flood zone by more than 10 percent each year. While most states regulate premium prices for private insurance companies on other lines of insurance, they generally do not set limits on premium rate increases, instead focusing on whether the resulting premium rates are justified by the projected losses and expenses.

NFIP's Premium Rates Do Not Reflect the Full Risk of Flooding

As we have seen, NFIP does not charge rates that reflect the full risk of flooding. NFIP could be placed on a sounder fiscal footing by addressing several elements of its premium structure. For example, as we have pointed out in previous reports, NFIP provides subsidized and grandfathered rates that do not reflect the full risk of potential flood losses to some property owners, operates in part with unreliable and incomplete data on flood risks that make it difficult to set accurate rates, and has not been able to overcome the challenge of repetitive loss properties.[9] Subsidized rates, which are required by law, are perhaps the best-known example of premium rates that do not reflect the actual risk of flooding. These rates, which were authorized from when the program began, were intended to help property owners during the transition to full-risk rates. But today, nearly one out of four of NFIP policies continue to be based on a subsidized rate. These rates allow policyholders with structures that were built before floodplain management regulations were established in their communities to pay premiums that represent about 35 to 40 percent of the actual risk premium. Moreover, FEMA estimates that properties covered by policies with subsidized rates experience as much as five times more flood damage than compliant new structures that are charged full-risk rates. As we have pointed out, the number of policies receiving subsidized rates has grown steadily in recent years and without changes to the program will likely continue to grow, increasing the potential for future NFIP operating deficits.

[9]See GAO, *Flood Insurance: FEMA's Rate-Setting Process Warrants Attention*, GAO-09-12 (Washington, D.C.: Oct. 31, 2008); and *Flood Insurance: Options for Addressing the Financial Impact of Subsidized Premium Rates on the National Flood Insurance Program*, GAO-09-20 (Washington, D.C.: Nov. 14, 2008).

Further, potentially outdated and inaccurate data about flood probabilities and damage claims, as well as outdated flood maps, raise questions about whether full-risk premiums fully reflect the actual risk of flooding. First, some of the data used to estimate the probability of flooding have not been updated since the 1980s. Similarly, the claims data used as inputs to the model may be inaccurate because of incomplete claims records and missing data. Further, some of the maps FEMA uses to set premium rates remain out of date despite recent modernization efforts. For instance, as FEMA continues these modernization efforts, it does not account for ongoing and planned development, making some maps outdated shortly after their completion. Moreover, FEMA does not map for long-term erosion, further increasing the likelihood that data used to set rates are inaccurate. FEMA also sets flood insurance rates on a nationwide basis, failing to account for many topographic factors that are relevant to flood risk for individual properties. Some patterns in historical claims and premium data suggest that NFIP's rates may not accurately reflect individual differences in properties' flood risk. Not accurately reflecting the actual risk of flooding increases the risk that full-risk premiums may not be sufficient to cover future losses and add to concerns about NFIP's financial stability.

Further contributing to NFIP's financial challenges, FEMA made a policy decision to allow certain properties remapped into riskier flood zones to keep their previous lower rates. Like subsidized rates, these "grandfathered" rates do not reflect the actual risk of flooding to the properties and do not generate sufficient premiums to cover expected losses. FEMA officials told us that the decision to grandfather rates was based on considerations of equity, ease of administration, and goals of promoting floodplain management. However, FEMA does not collect data on grandfathered properties or measure their financial impact on the program. As a result, it does not know how many such properties exist, their exact location, or the volume of losses they generate. As FEMA continues its efforts to modernize flood maps across the country, it has continued to face resistance from communities and homeowners when remapping places properties into higher-risk flood zones with higher rates. As a result, FEMA has often grandfathered in previous premium rates that are lower than the remapped rates. However, homeowners who are remapped into high-risk areas and do not currently have flood insurance may be required to purchase it at the full-risk rate.

In reauthorizing NFIP in 2004, Congress noted that repetitive loss properties—those that have had two or more flood insurance claims payments of $1,000 or more over 10 years—constituted a significant drain on NFIP resources. These properties account for about 1 percent of all policies but are estimated to account for up to 30 percent of all NFIP losses. Not all repetitive loss properties are part of the subsidized property inventory, but a high proportion receive subsidized rates, further contributing to NFIP's financial risks. While Congress has made efforts to target these properties, the number of repetitive loss properties has continued to grow, making them an ongoing challenge to NFIP's financial stability.

Despite Its Financial Challenges, NFIP Has Experienced Some Positive Developments

According to FEMA, expanded marketing efforts through its FloodSmart campaign have contributed to an increase in NFIP policies. This program was designed to educate and inform partners, stakeholders, property owners, and renters about insuring their homes and businesses against flood damage. Since the start of the FloodSmart campaign in 2004, NFIP has seen policy growth of more than 25 percent and as of February 2010 had 5.6 million policies in force. Moreover, despite the economic downturn, both policy sales and retention grew in 2009. Correspondingly, NFIP's collected premiums have risen 28 percent since September 2006. This increase, combined with a relatively low loss experience in recent years, has enabled FEMA to make nearly $600 million in interest payments to Treasury with no additional borrowing since March 2009. FEMA has also adjusted its expense reimbursement formula. While these are all encouraging developments, FEMA is still unlikely to ever pay off its current $18.8 billion debt.

FEMA's Operational and Management Issues May Further Limit Progress in Achieving NFIP Goals

We have identified a number of operational issues that affect NFIP, including weaknesses in FEMA's oversight of WYO insurers and shortcomings in its oversight of other contractors, as well as new issues from ongoing work. For example, we found that FEMA does not systematically consider actual flood insurance expense information when determining the amount it pays WYO insurers for selling and servicing flood insurance policies and adjusting claims. Instead, FEMA has used proxies, such as average industry operating expenses for property insurance, to determine the rates at which it pays these insurers, even though their actual flood insurance expense information has been available since 1997. Because FEMA does not systematically consider these data when setting its payment rates, it cannot effectively estimate how much insurers are spending to carry out their obligations to FEMA. Further, FEMA does not compare the WYO insurers' actual expenses to the payments they receive each year and thus cannot determine whether the payments are reasonable in terms of expenses and profits. When GAO compared payments FEMA made to six WYO insurers to their actual expenses for calendar years 2005 through 2007, we found that the payments exceeded actual expenses by $327.1 million, or 16.5 percent of total payments made. By considering actual expense information, FEMA could provide greater transparency and accountability over payments to WYO insurers and potentially save taxpayer money.

FEMA also has not aligned its bonus structure for WYO insurers with NFIP goals such as increasing penetration in low-risk flood zones and among homeowners in all zones that do not have mortgages from federally regulated lenders. FEMA uses a broad-based distribution formula that primarily rewards companies that are new to NFIP and can relatively easily increase their percentage of net policies from a small base. We also found that most WYO insurers generally offered flood insurance when it was requested but did not strategically market the product as a primary insurance line. FEMA has set only one explicit marketing goal—to increase policy growth by 5 percent each year—and does not review the WYO insurers' marketing plans. It therefore lacks the information needed to assess the effectiveness of either the WYO insurers' efforts to increase participation or the bonus program itself. For example, FEMA does not know the extent to which sales increases may reflect external factors such as flood events or its own FloodSmart marketing campaign rather than any effort on the part of the insurers. Having intermediate targeted goals could also help expand program participation, and linking such goals directly to the bonus structure could help ensure that NFIP and WYO goals are in line with each other.

Finally, FEMA has explicit financial control requirements and procedures for the WYO program but has not implemented all aspects of its Financial Control Plan. FEMA's Financial Control Plan provides guidance for WYO insurers to help ensure compliance with the statutory requirements for NFIP. It contains several checks and balances to help ensure that taxpayers' funds are spent appropriately. For an earlier report, we reviewed 10 WYO insurers and found that while FEMA performed most of the required biennial audits and underwriting and claims reviews required under the plan, it rarely or never implemented most of the required audits for cause, state insurance department audits, or marketing, litigation, and customer service operational reviews.[10] In addition, FEMA did not systematically track the outcomes of the various audits, inspections, and

[10] See GAO-09-455.

reviews that it performed. We also found that multiple units had responsibility for helping ensure that WYO insurers complied with each component of the Financial Control Plan; that FEMA did not maintain a single, comprehensive monitoring system that would allow it to ensure compliance with all components of the plan; and that there was no centralized access to all of the documentation produced. Because FEMA does not implement all aspects of the Financial Control Plan, it cannot ensure that WYO insurers are fully complying with program requirements.

In another review, we found that weak internal controls impaired FEMA's ability to maintain effective transaction-level accountability with WYO insurers from fiscal years 2005 through 2007, a period that included the financial activity related to the 2005 Gulf Coast hurricanes.[11] NFIP had limited assurance that its financial data for fiscal years 2005 to 2007 were accurate. This impaired data reliability resulted from weaknesses at all three levels of the NFIP transaction accountability and financial reporting process. At the WYO level, WYO insurer claims loss files did not include the documents necessary to support the claims, and some companies filed reports late, undermining the reliability of the data they did report. Second, contractor-level internal control activities were ineffective in verifying the accuracy of the data that WYO insurers submitted, such as names and addresses. Lastly, at the agency level, financial reporting process controls were not based on transaction-level data. Instead, FEMA relied primarily on summary data compiled using error-prone manual data entry.

FEMA's Oversight of Non-WYO Contractor Activities Is Also Lacking

Also in a previous report, we pointed out that FEMA lacked records of monitoring activities for other contractors, inconsistently followed its procedures for monitoring these contractors, and did not coordinate contract monitoring responsibilities for the two major contracts we reviewed.[12] At FEMA, a Contracting Officer's Technical Representative (COTR) and staff (referred to as "monitors") are responsible for, respectively, ensuring compliance with contract terms and regularly

[11]See GAO, *Financial Management: Improvements Needed in National Flood Insurance Program's Financial Controls and Oversight*, GAO-10-66 (Washington, D.C.: Dec. 22, 2009).

[12]See GAO, *Natural Flood Insurance Program: Financial Challenges Underscore Need for Improved Oversight of Mitigation Programs and Key Contracts*, GAO-08-437 (Washington, D.C.: June 16, 2008).

monitoring and reporting on the extent to which NFIP contractors meet standards in performance areas specified in the contracts. Internal control standards for the federal government state that records should be properly managed and maintained. But FEMA lacked records for the majority of the monitoring reports we requested and did not consistently follow the monitoring procedures for preparing, reviewing, and maintaining monitoring reports.

Further, FEMA offices did not coordinate information and actions relating to contractors' deficiencies and payments, and in some cases key officials were unaware of decisions that were made about contractors' performance. In particular, our review of monitoring reports for one contract revealed a lack of coordination between the COTR and the contracting officer. As a result, FEMA could not ensure that the contractor had adhered to the contract's requirements and lacked information critical to effective oversight of key NFIP data collection, reporting, and insurance functions. Given NFIP's reliance on contractors, it is important that FEMA have in place adequate controls that are consistently applied to all contracts. Consistent with our findings in prior work, the DHS inspector general has also identified weaknesses in FEMA's internal controls and financial reporting related to NFIP.[13]

FEMA Continues to Lack an Effective System to Manage Flood Insurance Policy and Claims Data

To manage the flood policy and claims information that it obtains from insurance companies, NFIP's Bureau and Statistical Agent (BSA) relies on a flood insurance management system from the 1980s that is difficult and costly to sustain and that does not adequately support NFIP's mission needs. This system consists of over 70 interfaced applications that utilize monthly tape and batch submissions of policy and claims data from insurance companies. The system also provides limited access to NFIP data. Further, identifying and correcting errors in submission requires between 30 days and 6 months, and the general claims processing cycle itself is 2 to 3 months.

To address the limitations of this system, NFIP launched a program in 2002 to acquire and implement a modernization and business improvement system, known as NextGen. As envisioned, NextGen was to accelerate

[13]See Department of Homeland Security, Office of the Inspector General, *Independent Auditor's Report on DHS' FY 2009 Financial Statements and Internal Control over Financial Reporting*, DHS-OIG-10-11 (Washington, D.C.: Nov. 13, 2009).

updates to information obtained from insurance companies, identify errors before flood insurance policies went into effect, and enable FEMA to expedite business transactions and responses to NFIP claims when policyholders required urgent support. As such, the system would support the needs of a wide range of NFIP stakeholders, including FEMA headquarters and regional staff, WYO insurers, vendors, state hazard mitigation officers, and NFIP state coordinators.

As part of our ongoing review of FEMA's management of NFIP, preliminary results reveal that despite having invested roughly $40 million over 7 years, FEMA had yet to implement NextGen. Initial versions of NextGen were first deployed for operational use in May 2008. However, shortly thereafter system users reported major problems with the system, including significant data and processing errors. As a result, use of NextGen was halted, and the agency returned to relying exclusively on its mainframe-based legacy system while NextGen underwent additional testing. In late 2009, after this testing showed that the system did not meet user needs and was not ready to replace the legacy system, further development and deployment of NextGen was stopped, and FEMA's Chief Information Officer began an evaluation to determine what, if anything, associated with the system could be salvaged. This evaluation is currently under way, and a date for completing it has yet to be established.

Our ongoing review of FEMA's management of NFIP includes identifying lessons learned about how NextGen was defined, developed, tested, and deployed, including weaknesses in requirements development and management, test management, risk management, executive oversight, and program office staffing that have collectively contributed to the program's failure. In completing its evaluation and deciding how to proceed in meeting its policy and claims processing needs, FEMA could benefit from correcting these weaknesses. In the interim, the agency continues to rely on its outdated legacy system and thus does not have the kind of robust analytical support and information needed to help address the reasons that NFIP remains on GAO's high-risk list of federal programs.

Addressing NFIP's Challenges Would Require Actions from FEMA and Congress

To address the challenges NFIP faces, FEMA would have to address its own operational and management challenges. Further, legislative reform would be needed to address structural issues. However, as you know addressing many of these issues involves public policy trade-offs that would have to be made by Congress. Moreover, part of this process requires determining whether NFIP is or should be structured as an insurance program and how much liability the government can and is willing to accept. For example, if Congress wants to structure NFIP as an insurance company and limit borrowing from Treasury in future high- or catastrophic loss years, NFIP would have to build a capital surplus fund. Our prior work has shown that building such a fund would require charging premium rates that, in some cases, could be more than double or triple current rates and would take a number of years without catastrophic losses to implement. Additionally, while private insurers generally use reinsurance to hedge their risk of catastrophic losses, it is unclear whether the private reinsurance market would be willing to offer coverage to NFIP. In the absence of reinsurance and a surplus fund, Treasury will effectively continue to act as the reinsurer for NFIP and be the financial backstop for the program.

Premium Rates Could Be Made More Reflective of Flood Risk

Making premium rates more reflective of flood risk would require actions by FEMA and Congress. Because subsidized premium rates are required by law, addressing their associated costs would require congressional action. As previously reported, two potential options would be to eliminate or reduce the use of the subsidies over time or target them based on need. However, these options involve trade-offs. For example, eliminating or reducing the subsidies would help ensure that premium rates more accurately reflected the actual risk of loss and could encourage mitigation efforts. But the resulting higher premiums could lead some homeowners to discontinue or not purchase coverage, thus reducing participation in NFIP and potentially increasing the costs to taxpayers of providing disaster assistance in the event of a catastrophe. Targeting subsidies based on need is an approach used by other federal programs and could help ensure that those needing the subsidy would have access to it and retain their coverage. Unlike other agencies that provide—and are allocated funds for—traditional subsidies, NFIP does not receive an appropriation to pay for shortfalls in collected premiums caused by its subsidized rates. However, one option to maintain the subsidies but improve NFIP's financial stability would be to rate all policies at the full-risk rate and to appropriate subsidies for qualified policyholders. In this way, the cost of such subsidies would be more transparent, and policyholders would be better informed of their flood risk. Depending on how such a program was implemented, NFIP might be able to charge more participants rates that more accurately reflected their risk of flooding. However, raising premium rates for some participants could also decrease program participation, and low-income property owners and renters could be discouraged from participating in NFIP if they were required to prove that they met the requirements for a subsidy. FEMA might also face challenges in implementing this option in the midst of other ongoing operational and management challenges.

NFIP's rate-setting process for full-risk premiums may not ensure that those premium rates reflect the actual risk of flooding and therefore may increase NFIP's financial risk. Moreover, FEMA's rate-setting process for subsidized properties depends, in part, on the accuracy of the full-risk rates, raising concerns about how subsidized rates are calculated as well. To address these concerns, we have identified actions that FEMA could take. For example, we recommended that FEMA take steps to help ensure that its rate-setting methods and the data it uses to set rates result in full-risk premium rates that accurately reflect the risk of losses from flooding. In particular, we pointed out that these steps should include verifying the accuracy of flood probabilities, damage estimates, and flood maps and reevaluating the practice of aggregating risks across zones. While FEMA disagreed with our analysis of its rate-setting methods, this area continues to warrant attention.

Similarly, because NFIP allows grandfathered rates for those remapped into high-risk flood zones, it would also be in the position to address some of the challenges associated with this practice. FEMA could end grandfathered rates, but it decided to allow grandfathering after consulting with Congress, its oversight committees, and other stakeholders and considering issues of equity, fairness, and the goal of promoting floodplain management. We recommended that the agency take steps both to ensure that information was collected on the location, number, and losses associated with existing and newly created grandfathered properties in NFIP and to analyze the financial impact of these properties on the flood insurance program.[14] With such information, FEMA and Congress will be better informed on the extent to which these rates contribute to NFIP's financial challenges.

Another statutory requirement that could be revisited is the 10-percent cap on rate increases. As with all the potential reform options, determining whether such action is warranted would necessitate weighing the law's benefits—including limiting financial hardship to policyholders—against the benefits that increasing or removing such limits would provide to NFIP, Treasury, and ultimately the taxpayer. However, as long as caps on rate increases remain, FEMA will continue to face financial challenges.

[14]See GAO-09-12.

Solutions for addressing the impact of repetitive loss properties would also require action by both Congress and FEMA. For example, we have reported that one option for Congress would be to substantially expand mitigation efforts and target these efforts toward the highest-risk properties.[15] Mitigation criteria could be made more stringent—for example, by requiring all insured properties that have filed two or more flood claims (even for small amounts) to mitigate, denying insurance to property owners who refuse or do not respond to a mitigation offer, or some combination of these approaches. While these actions would help reduce losses from flood damage and could ultimately limit costs to taxpayers by decreasing the number of subsidized properties, they would require increased funding for FEMA's mitigation programs to elevate, relocate, or demolish the properties, would be costly to taxpayers, and could take years to complete. Congress could also consider changes to address loopholes in mitigation and repurchase requirements that allow policyholders to avoid mitigating by simply not responding to FEMA's requests that they do so. FEMA could be required to either drop coverage for such properties or use eminent domain to seize them if owners failed to respond to FEMA's mitigation requests. Moreover, Congress could streamline the various mitigation grant programs to make them more efficient and effective.[16]

FEMA Could Take Further Actions to Help Address Operational and Management Challenges

Over the last several years, we have made many recommendations for actions that FEMA could take to improve its management of NFIP. FEMA has implemented some recommendations, including, among other things, introducing a statistically valid method for sampling flood insurance claims for review, establishing a regulatory appeals process for policyholders, and ensuring that WYO insurance agents meet minimum education and training requirements.[17] FEMA has also taken steps to make analyzing the overall results of claims adjustments easier after future flood events. The efforts will help in determining the number and type of claims

[15]See GAO-09-20.

[16]FEMA has five different mitigation grant programs, each with different types of requirements, purposes, and appropriations: Flood Mitigation Assistance (FMA), Repetitive Flood Claims (RFC), Severe Repetitive Loss Pilot Program (SRL), Hazard Mitigation Grant Program (HMGP), and Pre-Disaster Mitigation (PDM).

[17]See GAO, *Federal Emergency Management Agency: Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program*, GAO-06-119 (Washington, D.C.: Oct. 18, 2005).

adjustment errors made and deciding whether new, cost-efficient methods for adjusting claims that were introduced after Hurricane Katrina are feasible to use after other flood events.[18] However, as mentioned previously, many of our other previous recommendations have not yet been implemented. For example, we have recommended that FEMA:

- Address challenges to oversight of the WYO program, specifically the lack of transparency of and accountability for the payments FEMA makes to WYO insurers, by determining in advance the amounts built into the payment rates for estimated expenses and profit, annually analyzing the amounts of actual expenses and profit in relation to the estimated amounts used in setting payment rates, and by immediately reassessing the practice of paying WYO insurers an additional 1 percent of written premiums for operating expenses.

- Take steps to better oversee WYO insurers and ensure that they are in compliance with statutory requirements for NFIP and that taxpayers' funds are spent appropriately by consistently following the Financial Control Plan and ensuring that each component is implemented; ensuring that any revised Financial Control Plan covers oversight of all functions of participating WYO insurers, including customer service and litigation expenses; systematically tracking insurance companies' compliance with and performance under each component of the Financial Control Plan; and ensuring centralized access to all the audits, reviews, and data analyses performed for each participating insurance company under the Financial Control Plan.

- Improve NFIP's transaction-level accountability and assure that financial reporting is accurate and that insurance company operations conform to program requirements by augmenting NFIP policies to require contractors to develop procedures for analyzing financial reports in relation to the transaction-level information that WYO insurers submit for statistical purposes; revising required internal control activities for contractors to provide for verifying and validating the reliability of WYO-reported financial information based on a review of a sample of the underlying transactions or events; and obtaining verification that these objectives have been met through independent audits of the WYO insurers.

[18]See GAO, *National Flood Insurance Program: New Processes Aided Hurricane Katrina Claims Handling, but FEMA's Oversight Should Be Improved*, GAO-07-169 (Washington, D.C.: Dec. 15, 2006).

- Address contract and management oversight issues that GAO has identified in previous reports, including determining the feasibility of integrating and streamlining numerous existing NFIP financial reporting processes to reduce the risk of errors inherent in the manual recording of accounting transactions into multiple systems; establishing and implementing procedures that require the review of available information, such as the results of biennial audits, operational reviews, and claim reinspections to determine whether the targeted audits for cause should be used; establishing and implementing procedures to schedule and conduct all required operational reviews within the prescribed 3-year period; and establishing and implementing procedures to select statistically representative samples of all claims as a basis for conducting reinspections of claims by general adjusters.
- Address challenges to oversight of contractor activities, including implementing processes to ensure that monitoring reports are submitted on time and systematically reviewed and maintained by the COTR and the Program Management Office; that staff clearly monitor each performance standard the contractor is required to meet in the specified time frames and clearly link monitoring reports and performance areas; that written guidance is implemented for all NFIP-related contracts on how to consistently handle the failure of a contractor to meet performance standards; that written policies and procedures are established governing coordination among FEMA officials and offices when addressing contractor deficiencies; and that financial disincentives are appropriately and consistently applied.

Building on our prior work and these recommendations, we are in the process of conducting a comprehensive review of FEMA's overall management of NFIP that could help FEMA develop a roadmap for identifying and addressing many of the root causes of its operational and management challenges. This review focuses on a wide range of internal management issues including acquisition, contractor oversight, information technology (NextGen), internal controls, human capital, budget and resources, records management, and financial management.[19] While our work is ongoing, we have observed some positive developments

[19]We plan to issue this report later this year. We also are currently reviewing FEMA's flood mapping program at the request of the Chairman of the Subcommittee on Economic Policy, Senator Sherrod Brown, as well as Senators Charles E. Schumer and Jeff Bingaman. In particular, we are determining the extent to which FEMA ensures that flood maps accurately reflect flood risk and how FEMA promotes the community acceptance of flood maps. We plan to issue this report in December 2010.

in the agency's willingness to begin to acknowledge its management issues and the need to address them. FEMA has also taken steps to improve our access to key NFIP staff and information by providing us with an on-site office at one of FEMA's locations, facilitating our ability to access and review documents.

Recent Proposals Could Provide Some Benefits but Also Raise Concerns

As part of our past work, we have also evaluated other proposals related to NFIP. Each of those proposals has potential benefits as well as challenges.

- In a previous report, we discussed some of the challenges associated with implementing a combined federal flood and wind insurance program.[20] While such a program could provide coverage for wind damage to those unable to obtain it in the private market and simplify the claims process for some property owners, it could also pose several challenges. For example, FEMA would need to determine wind hazard prevention standards, adapt existing programs to accommodate wind coverage, create a new rate-setting process, raise awareness of the program, enforce new building codes, and put staff and procedures in place. FEMA would also need to determine how to pay claims in years with catastrophic losses, develop a plan to respond to potential limited participation and adverse selection, and address other trade-offs, including delays in reimbursing participants, litigation, lapses in coverage, underinsured policyholders, and larger-than-expected losses.
- As we have previously reported, private business interruption coverage for flood damage is expensive and is generally purchased only by large companies.[21] Adding business interruption insurance to NFIP could help small businesses obtain coverage that they could not obtain in the private market, but NFIP currently lacks resources and expertise in this area. Adding business interruption insurance could increase NFIP's existing debt and potentially amplify its ongoing management and financial challenges. Insurers told us that underwriting this type of coverage, properly pricing the risk, and adjusting claims was complex.

[20]See GAO, *Natural Catastrophe Insurance: Analysis of a Proposed Combined Federal Flood and Wind Insurance Program*, GAO-08-504 (Washington, D.C.: Apr. 25, 2008).

[21]See GAO, *Information on Proposed Changes to the National Flood Insurance Program*, GAO-09-420R (Washington, D.C.: Feb. 27, 2009).

- Finally, we have reported that creating a catastrophic loss fund to pay larger-than-average annual losses would be challenging, for several reasons.[22] For example NFIP's debt to Treasury would likely prevent NFIP from ever being able to contribute to such a fund. Further, such a fund might not eliminate NFIP's need to borrow for larger-than-expected losses that occurred before the fund was fully financed. Building a fund could also require significant premium rate increases, potentially reducing participation in NFIP.

Closing Comments

FEMA faces a number of ongoing challenges in managing and administering NFIP that, if not addressed, will continue to work against improving the program's long-term financial condition. As you well know, improving NFIP's financial condition involves a set of highly complex, interrelated issues that are likely to involve many trade-offs and have no easy solutions, particularly when the solutions to problems involve balancing the goals of charging rates that reflect the full risk of flooding and encouraging broad participation in the program. In addition, addressing NFIP's current challenges will require the cooperation and participation of many stakeholders.

As we noted when placing NFIP on the high-risk list in 2006, comprehensive reform will likely be needed to address the financial challenges facing the program. In addressing these financial challenges, FEMA will also need to address a number of operational and management challenges before NFIP can be eligible for removal from the list. Our previous work has identified many of the necessary actions that FEMA should take, and preliminary observations from our ongoing work have revealed additional operational and management issues. By addressing both the financial challenges as well as the operational and management issues, NFIP will be in a much stronger position to achieve its goals and ultimately to reduce its burden on the taxpayer.

Chairwoman Waters and Ranking Member Capito, this concludes my prepared statement. I would be pleased to respond to any of the questions you or other members of the Subcommittee may have at this time.

[22] See GAO-09-420R.

GAO Contact and Staff Acknowledgments

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. For further information about this testimony, please contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov. This statement was prepared under the direction of Patrick Ward. Key contributors were Tania Calhoun, Emily Chalmers, Nima Patel Edwards, Elena Epps, Christopher Forys, Randy Hite, Tonia Johnson, and Shamiah Kerney.

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Testimony of David R. Conrad

Senior Water Resources Specialist

National Wildlife Federation

Regarding

Legislative Proposals to Reform the National Flood Insurance Program

Before the

Subcommittee on Housing and Community Opportunity

House Committee on Financial Services

U.S. House of Representatives

April 21, 2010

Good Morning Chairwoman Waters and Ranking Member Capito and Members of the Subcommittee. I am David R. Conrad and I serve as Senior Water Resources Specialist for the National Wildlife Federation, the nation's largest conservation education and advocacy organization with more than four million members and supporters and affiliate conservation organizations in 47 U.S. states and territories. We greatly appreciate the opportunity to offer our views on legislation to reform the National Flood Insurance Program.

The National Wildlife Federation has had a long and active involvement in the National Flood Insurance Program and we were deeply involved in the legislative reform efforts for this program leading to the 1994 and 2004 NFIP Reform Acts. Unfortunately, despite the program's having provided needed insurance for millions of Americans, having accomplished some of its original goals, and despite some important improvements made in these Reform Acts, including some improved lender compliance, establishment of a Community Rating System and a Flood Mitigation Assistance Program and Severe Repetitive Loss Program, the NFIP now finds itself in the deepest and most serious trouble of its entire 42-year history and without help it could be in danger of eventual collapse.

NFIP Facing Its Greatest Crisis and Challenges in the Program's History

The NFIP currently faces a debt of $18.75 billion to the U.S. Treasury, a debt service which is likely to rise in the near future, annual revenues of only $3 billion and virtually no possibility of being able to repay the debt from program revenues. It is in essence bankrupt. While the program has established some minimum standards that are now in place in most communities, it has fundamentally failed to keep pace with and to substantially discourage and reduce the buildup of flood risks and damages across the nation. It has also contributed to the deterioration and loss of important floodplain and coastal habitat areas and decline of valuable and sensitive ecosystems. The program is also now facing a major taxpayer bailout, but given the many problems the program continues to face, we have little reason to believe or confidence that without major changes, this scenario will repeat itself over and over in the future. We do not believe the public or Congress would ultimately continue the program under such conditions.

The NFIP was originally founded on a strategy developed by eminent scientists and government officials in the early 1960's which combined the ideas of identifying flood risks (generally through mapping), developing and implementing risk-reducing land use and building codes, and providing affordable insurance that was not otherwise available in the private markets. Forty years later, we find major failures on each of these fronts, we believe largely because of failure to charge actuarially sound rates and to aggressively mitigate risks. National flood damages, particularly from major flooding events – rather than decreasing as the founders would have hoped – are now rising almost exponentially.

The NFIP has failed to adequately restrict growth in high-risk floodprone and environmentally-sensitive areas. Additionally, there is growing evidence that frequency and severity of major storms and hurricanes are increasing in many areas due in part to climate change and sea-level rise factors and land development, yet the NFIP has done little to anticipate the enormous potential for flood-related losses these changes portend.

Climate Change Presents Significant New Threats of Flooding.

Climate change is causing heavier rainfall, changing patterns of snowfall, bringing more severe hurricanes, and increasing sea level, all of which will increase flooding risk and likely exacerbate already increasing flooding damage. Across the nation, precipitation is already more likely to fall in heavy downpours than in light sprinkles, a trend expected to continue as the atmosphere continues warming.[1]

- In the Midwest and Northeast, big storms that historically would only be seen once every 20 years are projected to happen as often as every 4 to 6 years by the end of the 21st century.[2]
- Winter precipitation is beginning to shift toward more rain instead of snow. The fraction of wintertime precipitation falling as snow declined by 9 percent since 1949 in the Western United States and 23 percent in the Northeast. The biggest shifts from snow to rain are in March for all regions studied, December in New England, and January along the Pacific coast.[3]
- Rain-on-snow events may become more common in some locations.[4] Recent events in the Pacific Northwest have caused extensive and notable flooding. In January 2009, tens of thousands were evacuated and major transportation routes were closed when 10 inches of rain fell over 2 days, causing major snow melt and flooding in western Washington State.[5]

At the same time, scientists have been gaining confidence in projections for more intense hurricanes and tropical storms in the future, even as they continue to debate whether they can detect the signal of climate change in the records of past storms. The latest studies indicate that hurricanes will have stronger winds and more rainfall, but will become somewhat less frequent.[6]

- The mean maximum wind speed of tropical cyclones is likely to increase by 2 to 11 percent globally by the end of the century. The biggest changes may occur for the most intense storms, with the wind speeds of these storms increasing by a significantly larger

[1] CCSP, 2008a. *Weather and Climate Extremes in a Changing Climate. Regions of Focus: North America, Hawaii, Caribbean, and U.S. Pacific Islands.* A Report by the U.S. Climate Change Science Program and the Subcommittee on Global Change Research. [Thomas R. Karl, Gerald A. Meehl, Christopher D. Miller, Susan J. Hassol, Anne M Waple, and William L. Murray (eds.)] Department of Commerce, NOAA's National Climatic Data Center, Washington DC, USA, 164 pp.
[2] CCSP, 2008a
[3] CCSP, 2008a
[4] Hamlet, A.F., and D.P. Lettenmaier, 2007. Effects of 20th Century Warming and Climate Variability on Flood Risk in the Western U.S., Water Resources Research 43:W06427.
[5] Mapes, L.V., January 1, 2010, 2009 Was a Year of Weather Extremes. The Seattle Times.
6 Knutson, T.R., et al., 2010. Tropical cyclones and climate change. Nature Geosciences Advance Online Publication on February 21, 2010, DOI: 10.1038/NGEO779.

percentage.[7] While these changes in wind speed may seem small, they can translate into large increases in damages. For example, a 10 percent increase in wind speed of a category 4 hurricane can increase damages by about 50 percent.[8]

- All climate models project more rainfall from tropical cyclones in a warmer climate. The latest projections are that rainfall from hurricanes may increase from 3 to 37 percent.[9] The average increase projected by the late 21st century is about 20 percent within 62 miles of the storm center.[10]

Sea-level rise will even further increase the vulnerability of states along the Gulf and Atlantic coasts to storm-surge flooding. When a tropical storm hits, higher sea-level translates into bigger storm surges that can cause flooding further inland. Sea-level rise will also endanger coastal wetlands and barrier islands that form a first line of defense and help buffer coastal areas against hurricanes and storm surges. Even in the unlikely circumstance that the characteristics of tropical cyclones do not change, scientists are highly confident that sea level is rising and that coastal areas will have a greater risk of damaging storm surge. Globally, sea level has already increased by about 7 inches over the past century due to thermal expansion of water and the melting of land-based glaciers and ice.[11] Additional increases in sea level are considered inevitable; the question only remains as to how much and how fast.

- In 2007, the Intergovernmental Panel on Climate Change projected that sea level would rise 7 to 23 inches by 2100.[12] More recent studies indicate that sea level could rise much more rapidly; for example, Martin Vermeer and Stefan Rahmstorf projected 2.4 to 6.2 feet of sea-level rise over the same time period.[13] To put this in perspective, a two-foot rise in sea level would mean regular inundation for 2,200 miles of major roads and 900 miles of railroads in Maryland, Virginia, North Carolina and the District of Columbia.[14]
- Ideally, coastal wetlands (and their ability to buffer storm surge impacts) would survive by migrating inland as sea levels rise. However, a recent study of land-use plans for states

[7] Knutson et al., 2010.
[8] CCSP, 2008a
[9] Knutson et al., 2010.
[10] Knutson et al., 2010.
[11] Intergovernmental Panel on Climate Change (IPCC), 2007. Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change [Solomon, S., D. Qin, M. Manning, Z. Chen, M. Marquis, K.B. Averyt, M. Tignor and H.L. Miller (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, 996 pp.
[12] IPCC, 2007.
[13] Vermeer, M., and S. Rahmstorf, 2009. Global sea level linked to global temperature. *Proceedings of the National Academy of Sciences.* 106(51): 21,527–21,532.
[14] CCSP. 2008b. Impacts of Climate Change and Variability on Transportation Systems and Infrastructure: Gulf Coast Study, Phase I.A Report by the U.S. Climate Change Science Program and the Subcommittee on Global Change Research [Savonis, M.J.,V.R. Burkett, and J.R. Potter (eds.)].Department of Transportation, Washington, DC, USA, 445 pp.

and local areas along the U.S. Atlantic coasts found that less than 10 percent of land within about 3 feet of the current sea level has been set aside for conservation.[15]

Broad Changes Are Needed.

The National Wildlife Federation believes the NFIP is in immediate need of a complete and total review to overhaul the program and to devise new strategies to address its missions. We are extremely concerned the legislation under consideration here today will fall far short of addressing the most critical problems facing the program. Some of the measures proposed in the legislation have major potential to make the financial and environmental problems worse.

Broadly speaking, we believe many changes should be made to place the NFIP on a more sound footing. To seriously improve the program, the following broad actions should be taken:

- all rates should be moved to actuarial levels to reflect the true risk of flood hazards;
- means-tested assistance should be developed for low income homeowners and renters to obtain needed insurance while also finding the means to mitigate their own flood risks;
- flood hazard maps and risk identification should be substantially improved and expanded to include potential inundation areas below dams and behind levees and other flood control system structures in the event of failures, and to reflect a range of other flood risks such as erosion areas, ice jams and other hazards;
- flood maps should also be expanded to reflect reasonably foreseeable risks from climate change and sea-level rise effects, and should identify more than simply the risk of a 1-percent annual chance flood level, but include a variety of flood potentials and risks based on reasonably anticipated future conditions, including from changes in land use and watershed development and effects of urbanization;
- flooding risks must be much better communicated to the public;
- mandatory flood insurance purchase requirements should be expanded – not contracted – to include areas with these additional risks;
- improved and stronger land use regulations, building codes, and building elevation requirements and freeboards, including limitations on floodplain filling and construction in places such as natural floodways, on barrier islands and coastal surge zones, and in areas providing important natural and beneficial ecological functions, fish and wildlife habitat and natural services (such as water quality, groundwater recharge, and sediment and erosion control) should be required and implemented;
- hazard mitigation and protection of key natural and beneficial functions must be made the heart of the NFIP's risk reduction strategy – not a side exercise.

Urge a Three-Year Reauthorization to Match Obama Administration Approach

[15] Titus, J.G., et al., 2009. State and local governments plan for development of most land vulnerable to rising sea level along the US Atlantic coast. *Environmental Research Letters* 4: 044008 (7pp).

The legislation before the Committee does not address most of the above concerns. We understand the goal of the current legislation is primarily to address certain immediate financial concerns and has not been intended to address the full range of failings and issues facing the NFIP. We are greatly encouraged by FEMA Director Craig Fugate's and the Obama Administration's decision to initiate a major two-year effort to review the NFIP, with the intent to make comprehensive administrative and legislative recommendations to guide the course of this program into the future. This effort has tasked a FEMA NFIP Working Group to identify and analyze options for the future of the NFIP, including the results of a listening session conducted in November, 2009, with over 100 stakeholder representatives and experts, additional listening sessions, review of scores of studies and reports that have been prepared in recent years.

We are concerned, however, that the Discussion Draft proposes a 5-Year NFIP reauthorization without addressing many of the program's fundamental problems. We would strongly urge instead that the authorization be limited to possibly 30 months or at most three years, because the history of such long-term authorizations is often to delay critical attention being paid to addressing systemic problems, many of which will require Congressional action for resolution. We do not believe the longer period will likely bring stability to this sector of the housing market, but what is most needed for stability is a rapid and honest response to the major challenges faced by the NFIP.

Oppose Addition of Wind Insurance to NFIP -- H.R. 1264, Multiple Peril Insurance Act of 2009

H.R. 1264 proposes that insurance against wind damage be added to the National Flood Insurance Program. The National Wildlife Federation believes such an addition could severely undermine an already staggering NFIP. We strongly urge members of the Committee to oppose such an addition.

While we have great sympathy for homeowners who experienced post-Katrina difficulties in adjusting wind and flood claims, we believe these are areas that should be left to state insurance regulation systems and FEMA adjustment procedures. We do not believe the Federal government should get into the business of assuming liabilities and responsibilities for wind coverage that has largely been well-served by private sector insurance and reinsurance industries. Wind-related insurance coverage is not an area in which FEMA or the NFIP have special expertise. The total risk potential of wind damages could dwarf the risks related to floods.

In addition, H.R. 1264 would make citizens believe that they are protected from catastrophic losses, when they are not. Despite the bill's statement that rates are intended to be actuarial, it is precisely the shift of risk to the Federal government that could result in rates that mask the true risks of wind hazards and remove an important signal for residents to manage and mitigate their own risks. For over forty years this has been a key weakness of the NFIP, and H.R. 1264 will only exacerbate and amplify that weakness.

The bill seriously fails to establish any effective means of mitigating and reducing risks. Provisions such as requiring that coverage be limited "unless an appropriate public body shall have adopted adequate mitigation measures . . . consistent with . . . International Code Council building codes relating to wind mitigation" still would leave FEMA without effective tools directly or indirectly to control and manage land use and zoning (which building codes do not address), and would fail to manage many of the critical risks the bill proposes to insure.

At this time, when the NFIP is truly in a financial crisis, having failed to adequately manage flooding risk after forty years, we believe it would be a major mistake to add wind coverage, a major peril once again for which FEMA lacks any track record or special expertise, and which we believe would distract attention from much needed critical NFIP program reform efforts.

April 15, 2010 "Flood Insurance Reform and Priorities Act of 2010" Discussion Draft -- General Comments

Once again, we appreciate this Subcommittee's efforts to develop reform legislation for the National Flood Insurance Program. As we have said we continue to be concerned that the Draft legislation is thus far narrowly constrained to financial and rate related issues, but we understand that this is not intended to be the comprehensive reform legislation that will be needed. There is no question that with the growing effects of climate change, population growth and changes in watersheds and land uses, much more needs to be done now and in the very near future to address flooding risks and the way the NFIP is structured and operated to be fiscally and environmentally sound.

In general the history of the NFIP has been that subsidized flood insurance rates are created, but afterward the subsidized rates are seldom, if ever, moved to actuarial levels. We are pleased that Section 5 if the bill mandates a five-year phase out of pre-FIRM subsidies for two major classes of properties -- nonresidential properties and non-primary residences. Long-grandfathered vacation homes, second homes and business properties will have rates moving closer to reflecting their true flood risk. In a few years this will help stem the substantial annual losses associated with these flood insurance policiesWe urge Members to consider amending this provision to add other major classes of heavily subsidized classes of properties that are heavily impacting the financial health of the NFIP.

Repetitive Loss Properties and Severe Repetitive Loss Properties.

In 1998, the National Wildlife Federation completed and released a landmark report entitled *Higher Ground* on the NFIP repetitive flood loss properties – those that have two or more paid claims of at least $1000 each over a rolling 10-year period. At that time our report showed there were 74,501 repetitive loss properties in the NFIP – approximately 2 percent of insured properties – with 200,182 paid claims from 1978 – 1995, which had cost the NFIP $2.581 billion – approximately 40 percent of all claims paid.

Today, despite Congress' efforts in the 1994 and 2004 Flood Insurance Reform Acts, the total number of repetitive loss properties has grown to 153,000 repetitive loss properties with 447,700 claims that have cost the NFIP $10.692 billion. Within these properties, 9129 properties are "severe repetitive losses" with 50,607 losses that have cost the NFIP over $1.5 billion.

Many of these properties have for decades continued to receive highly-subsidized pre-FIRM rates. The subsidies have continued to discourage many building owners to substantially mitigate risks. We would strongly urge the Committee to amend Section 5 to include severe repetitive loss properties and repetitive loss properties whose cumulative claims exceed the fair market value of the property to non-residential and non-primary residential properties being phased-in to receive actuarial rates.

Finally, and as we describe in the detailed comments below, the Federation is extremely concerned about provisions in Sections 6 and 10 in the Discussion Draft that would delay or waive the requirements for mandatory flood insurance purchase where residents remain vulnerable and inadequately protected from flooding. We urge the Committee to reject such provisions. These run contrary to basic premises of the NFIP and should not be included in any flood insurance reform bill.

Specific Comments on Discussion Draft:

Sec. 2. Findings and Purposes.

We recommend three findings be added: first, to recognize the very difficult financial condition that exists with the NFIP; second, that FEMA is undertaking a major up-to-two year critical review and comprehensive analysis to consider the largest breadth of public policy options to make recommendations regarding issues of immediate concern and to establish a solid foundation for the NFIP's future; and third, that this review should be timely delivered to Congress and it is expected along with other studies and reports to assist Congress and the Administration to comprehensively address many of the problems that may not be comprehensively addressed in the present legislation.

Sec. 3. Extension of the National Flood Insurance Program. The Federation strongly recommends that the extension in this section be for **not longer than three years**. FEMA is currently embarking on an important up-to-two-year review to make comprehensive legislative and administrative recommendations for the Program's future. A longer authorization would likely delay concerted action in response to this critical review.

Sec. 4. Maximum Coverage Limits. The Federation urges the Committee not to increase NFIP maximum coverage limits at this time, but instead to urge FEMA to promote more availability of private sector coverage perhaps among WYO companies for the higher level amounts. We understand more of a market has begun to develop in recent years to provide additional coverage.

Sec. 5. Phase-In of Actuarial Rates for Nonresidential Properties and Non-Primary Residences.

The Federation supports moving all non-residential and non-primary residential properties to actuarial rates. Our 1998 *Higher Ground* report identified the subsidized rates of many repetitive loss properties receiving their insurance at less than 40 percent of actuarial rates were often not sufficiently incentivized to mitigate their risks, and the costs of these properties were and continue to be a major drain on the NFIP Fund. We recommend in addition that subsidized rates for other high-loss properties be moved to actuarial levels, such as ***severe repetitive loss properties, properties with cumulative losses that exceed the property value, or properties with substantial damage or substantial improvement properties.***

Sec. 6. 5-Year Delay In Effective Date of Mandatory Purchase Requirement for New Flood Hazard Areas.

The Federation strongly opposes this provision as drafted because it would leave property owners in flood hazard areas vulnerable to major losses with only greatly limited disaster assistance as a back-up. This provision should be stricken. The rate phase-in proposed in Section 7 is a better mechanism to lessen the degree of immediate impact of being newly mapped into special flood hazard areas, while assuring homes and businesses are covered for the known high hazard risk.

Sec. 7. 5-Year Phase-In of Flood Insurance Rates for Newly Mapped Areas.

This section establishes a 5-year phase-in to the actuarial risk-based rate for any properties newly mapped into special flood hazard areas in increments of 20 percent of the actuarial rate added each year. The Federation understands that, especially for low-income homeowners and renters, the new cost of flood insurance may be a financial hardship, and we would support such a phase-in for these properties of low income residents. It is critical especially for these residents to have flood insurance. Many of these residents would be the least able to afford the devastation associated with significant flood damages, and mitigation of their risk should be the principal and overriding Federal objective.

We would urge that the Committee consider a more rapid phase-in to actuarial rates of other properties, including second homes, vacation homes and business properties, such as two to four years. This would further limit the exposure of Federal taxpayers for large potential losses and appropriately incentivize risk mitigation by the owners and their communities.

We would also urge consideration of potential means-tested Federal housing aid for low-income residents over a limited period. We are concerned about creating a moral hazard, however, in the event of any permanent-type subsidization of lower income residents to live in high hazard flood prone areas. Any such assistance or voucher-type program must be accompanied by hazard mitigation assistance, as well.

Sec. 8. Increase in Annual Limitation on Premium Increases.

NWF supports this provision. The provision raises the cap on annual premium rate increases from 10 to 20 percent, allowing FEMA to bring rates toward actuarial more easily. Affordability issues should be addressed differently and not by masking true actuarial risk-based rates.

Sec. 9. Consideration of Construction, Reconstruction, and Improvement of Flood Protection Systems in Determination of Flood Insurance Rates.

The Federation urges modification of this Section. NWF is concerned that in Section 9 in those situations where local flood protection systems have been found to be disaccredited and local agencies or flood protection system owners are attempting to get a restoration zone status to set rates for properties as if the flood protection system were restored and in place, the position of FEMA and the Federal government is substantially weakened by removing Federal agency discretion in finding whether the flood protection system is "restorable," by expanding the provision to include coastal flood protection systems which in many cases are temporary and not reliable in the long term, and by potentially reducing the criteria for "adequate progress" toward restoring flood protection systems, such that it could be many years before actual restoration is completed. For example, coastal flood protection projects – often bulkheads, sea-walls, jetties or beach sand pumping and placement that can rapidly deteriorate – especially in the face of increasing sea-level rise and more powerful coastal storms. Thus with these amendments the NFIP could wind up providing major rate subsidies for long periods or potentially indefinitely. This would, once again, likely result in discouraging many building owners and residents to mitigate their own risks, and would expose the Federal taxpayers now backstopping the currently insolvent NFIP to much greater losses.

We urge that, at the very least, these provisions be modified to retain Federal agency and FEMA judgment and concurrence on whether the flood protection system is "restorable," and FEMA must retain key involvement. It is critical that the legislation not discourage or impair FEMA's ability to assure that the conditions and timing of construction, completion and fiscal arrangements in restoring protection will be completed and operational in a relatively short time. If not, it is not reasonable to extend the level of highly subsidized insurance for a long and especially open-ended period, especially where there is no involvement of Federal agencies or funds in restoring the flood protection system.

Sec. 10. Treatment of Certain Flood Protection Projects.

The Federation **strongly opposes** this provision. It would leave many people at risk of flooding without flood protection or flood insurance. We urge that this provision be stricken. It would permanently exempt from the NFIP's mandatory purchase requirement any area that has previously been certified with protection from at least the 1 percent annual chance flood (100-year flood). Even if conditions have radically changed, the bill would continue to exempt these areas from the mandatory purchase requirement. We do not believe this is wise policy and it would leave potentially hundreds of thousands of residents who are at substantial risk of flooding without flood insurance.

Second, Section 10 would permanently set the rates for flood insurance at the lowest possible rate while a restoration of the flood protection system is proceeding. Because the bill would weaken Federal discretion and judgment on whether the restoration was proceeding at a reasonable and rapid rate the Federal taxpayers are at risk of major losses. It appears that the same extremely low rate would apply even if it has been determined, based on changed "waterflow data or other scientific information obtained after, or that has changed since, commencement of construction, reconstruction, or improvement," that the flood protection system would not provide 100-year level of protection, even when it is completed.

There are hundreds of potential situations across the nation where this provision could ultimately apply. We are aware of at least one case on the Middle Mississippi River where recent scientific studies exhibit cavalier and potentially irresponsible manipulation of hydrologic data that may have resulted in significant underestimation of flood elevations from large floods, thus masking the true flooding risk for major populations in that region.[16] In this case, scientists are currently saying that flood risks are substantially higher than Corps of Engineers flow frequency models identify and thus the NFIP flood maps are also underestimating the risk. The Federation strongly urges the Committee not to adopt such language, which would bar FEMA from applying the NFIP requirements to properly inform the public and assure the necessary purchase of insurance to assist and protect residents where true flood risks exist.

Sec. 11. Exception to Waiting Period for Effective Date of Policies. Such an exception when a policy is purchased within 30 days of a purchase or transfer of property seems reasonable.

Sec. 12. Enforcement. The Federation supports strengthening penalties for failures by lenders to meet NFIP requirements associated with the mandatory purchase requirements. Any penalties collected are used for mitigation activities, which also improve the financial condition of the NFIP. We urge the Committee to strike the provision's "good faith" exception, which might negate the intended effect of spurring lenders to improve their compliance.

Sec. 13. Notification of Tenants of Availability of Contents Insurance. NWF supports this provision to improve outreach to tenants.

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[16] Pinter, N., et. Al., Historical discharge measurements on the Middle Mississippi River, USA: no basis for 'changing history' *Hydrol. Process.* **24**, 1088–1093 (2010)

Sec. 14. Flood Insurance Outreach Grants. Sec. 14 authorizes up to $50,000,000 annually for 5 years (FY 2011-2015) for up to 75 percent grants to local communities for education and outreach to owners and tenants on availability and value of purchasing insurance. Such a program should also include outreach regarding flood risk mitigation for homeowners, renters and businesses, and should include state-level involvement.

Sec. 16. Authorization of Additional Staff. The Federation would support this authorization of additional staffing at FEMA.

Sec. 19. Study Regarding Mandatory Purchase Requirement for Natural 100-Year Floodplain and Non-Federally Related Loans.

Given the Federation's increasing concerns regarding how climate change and sea-level rise are in many areas increasing flooding risk and increasing uncertainty of future large floods the nation may experience, the Federation supports expanding the areas and numbers of homeowners that carry flood insurance. A provision with this title was included in the House-passed H.R. 3121 in the 110th Congress, however, the language in the Discussion Draft is only limited to a study of expanding coverage requirements to non-Federally Related Loans, and does not include a study "Regarding Mandatory Purchase Requirement for Natural 100-Year Floodplain."

Rather than authorizing a study, the Federation would strongly urge the Committee to amend this section to authorize FEMA to expand its mapping program, working with other federal agencies and state and local partners, to add identification of "natural 100-year floodplains" and "residual risk areas," including inundation areas below dams and behind levees and other flood control structures in the event of failure of protection systems, and authorize the Director of FEMA to extend mandatory purchase and set appropriate risk-based flood insurance rates for these risk zones. These are critical areas to be added to the NFIP to provide protection to the public and as the effects of global warming, aging of the nation's infrastructure and other developments are occurring.

Conclusion

Once again, the National Wildlife Federation greatly appreciates the opportunity to provide our views on legislation to reform the National Flood Insurance Program. We look forward to working with the Committee as the process continues, and I would look forward to responding to any questions Members may have.

TESTIMONY OF MARK DAVEY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
FIDELITY NATIONAL INSURANCE COMPANY
ON BEHALF OF THE
WRITE-YOUR-OWN FLOOD INSURANCE COALITION

"THE NATIONAL FLOOD INSURANCE REFORM AND MODERNIZATION ACT OF 2010"
AND
H.R. 1264, "THE MULTIPLE PERIL INSURANCE ACT OF 2009"

FINANCIAL SERVICES SUBCOMMITTEE
ON HOUSING AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES
APRIL 21, 2010

My name is Mark Davey and I am President and Chief Executive Officer of Fidelity National Insurance Company. We recognize and share your concerns regarding the National Flood Insurance Program (NFIP) and natural catastrophe issues and we are here today to offer solutions to protect consumers.

Fidelity National is a "Write-Your-Own" (WYO) flood insurance partner with the NFIP and the largest writer, through this Program, of flood insurance in the nation. Fidelity National is also a member of the WYO Flood Insurance Coalition, a group that includes the 85 private insurers that participate in this Program and the national property/casualty trade associations. Thank you for the opportunity to appear before you today on behalf of Fidelity National and the WYO Flood Insurance Coalition.

Introduction

The NFIP has experienced five short-term extensions in just the past few months leading up to this hearing – including two "lapses" when the Program was essentially unable to write new business and provide vital coverage to homes and businesses. These developments have hindered numerous consumer housing closings and caused significant market uncertainty for our nation's 5.5 million NFIP policyholders, real-estate professionals and lenders. Fidelity National and the other 84 "Write-Your-Own" insurers are also very concerned about these short-term extensions and the uncertainty surrounding the future of this vital program.

With respect to the Multiple Peril Insurance Act, unlike the NFIP and some other sectors of the financial services industry, homeowners insurers are sound, stable and able to provide wind coverage where government does not displace markets. Global reinsurance capacity has increased, even after the recent financial crisis, and the homeowners insurance industry has continued to be very strong and stable, with low leveraging and high liquidity to maintain our ability to provide wind coverage without pause during these volatile economic times. Where government maintains regulatory stability and allows insurers to compete like other industries with market-based rates, the private markets are highly effective, efficient, and able to fulfill consumer needs.

Expansion of the NFIP to include wind and any other natural catastrophe insurance issue will ultimately drive out private sector capital and competition, leaving taxpayers with massive risk exposures. To the extent that there are political imperatives to address very specific constituent groups with very specific needs, we believe that discrete and narrowly targeted, market-based solutions should be used rather than a large scale government expansion of the NFIP.

National Flood Insurance Program Reauthorization/Reforms

Insurers like Fidelity National seek a long-term reauthorization of the NFIP to protect consumers and help increase stability for real estate professionals and lenders. We believe that a long-term commitment from Congress will provide WYO insurers with the certainty they need to allocate precious resources to continue a long-term relationship with the NFIP to help administer the Program and provide vital flood protection to our nation. Currently, Congress has entered into a cycle of enacting a series of short-term extensions for the NFIP which has already led to two lapses in the Program's coverage in 2010. WYO insurers and the industry are concerned with the constant short-term extensions and the negative impact it is having on consumers and taxpayers.

Floods are the most common natural disasters to occur in the United States and the NFIP provides over 5.5 million Americans with needed flood insurance coverage. Property damage caused by a flood is not covered under typical personal and commercial property policies. Flood insurance must be bought as a separate policy through the NFIP, which is the primary source for flood insurance in the country.

This year's heavy spring storms serve as yet another reminder that all Americans, not just those in coastal states, need the protection provided by the NFIP. There are NFIP policies in place in every state. In 2008, the average NFIP flood claim was $42,000 per homeowner, with over $2.5 billion in flood damages paid to consumers through the Program. This August will be the fifth anniversary of Hurricane Katrina, and in 2005 flood loss payments from hurricanes Katrina, Rita and Wilma totaled $17.6 billion – the highest amount on record. It is important that we learn from the past to prepare for the future.

Government insurance programs are rarely actuarially sound despite the best intentions of Congress. In fact, the NFIP was created in 1968 in part based on a report by HUD that indicated even if the private insurance industry were to have offered flood insurance on a sound actuarial basis, inhabitants of flood prone areas would have rejected unsubsidized coverage as too costly or too uneconomical. Following the severe 2004 and 2005 hurricane seasons, the NFIP remains heavily in debt. Saddled with almost $1 billion in interest payments on an $18.2 billion loan, it is unlikely that the Program will ever be able to pay off its "credit card." Political pressures will probably prevent the Program from ever achieving market-comparable premium rates or accumulating a safety-net surplus as is required of private insurers.

Regretfully, we do not believe that the Program can recover unless this massive debt is forgiven. In conjunction with forgiving the debt, significant reforms are critical. Once the debt is forgiven, the Program could then "start over" with reforms in place that would put the NFIP back on stronger financial footing. In order to accomplish this goal, the NFIP must ensure that premiums for flood coverage reflect the true costs to taxpayers so that expensive government flood loss subsidies can be eliminated over time.

Insurers participating in the WYO program are responsible for helping administer 95 percent of the NFIP business. Unfortunately, despite continued expensive education and outreach efforts by WYO companies, the number of homeowners and businesses purchasing flood insurance protection has already dropped following its peak after the severe 2004 and 2005 hurricane seasons. Participation in the Program needs to continue to grow. Consumers need to be educated about the importance of having flood insurance and encouraged to continue purchasing it.

Through the partnership established by the WYO program, our company, Fidelity National, is a leading provider of flood insurance. Administering and marketing the flood program is very complex and expensive, and the number of insurers willing to do so under the current federal compensation formula has significantly declined. As fewer private companies have been willing to market the product, it is not surprising that fewer consumers have purchased the product. Unfortunately, this cycle may lead to additional adverse selection and could necessitate further "borrowing" and significant taxpayer exposure through federal aid following a major catastrophe.

There have been recent discussions regarding possible privatization of flood insurance. Industry risk-bearing and pooling was attempted in the 1970s. It was heavily subsidized by the federal government and insurer participation dwindled to the point that the federal government took the risk back. In the 1980s, the WYO program was established to increase consumer purchases of the product. Private insurers set premiums and spread risk amongst all those exposed to loss, not just the ones most likely to incur a loss. Even with a federal program, the vast majority of those who purchase flood insurance do so only because it is required by their mortgage lenders and the likelihood of loss is significant. And political pressures make it extremely unlikely that long-term rate and underwriting freedom would ever be allowed sufficiently to compete for private capital. Before revisiting the privatization issue, we would encourage Congress to take a long, hard look at how such a program would work.

Our industry is also concerned with the lack of exclusive federal jurisdiction over the Program and we continue to encourage Congress to make sure that any and all issues related to the sales and administration of this Program fall under the federal law. The NFIP is overly complex and a consistent interpretation of legal issues through the federal judicial system is necessary. Establishing exclusive federal jurisdiction over all aspects of this Program would also help control litigation costs, which are borne by the NFIP, thus leading to more stable flood insurance premiums.

While the private sector does not currently bear the costs of government subsidies to flood plain consumers, Fidelity National and other WYO insurers believe as a matter of public policy that reforms are needed and that subsidies should be phased out and premiums should be risk-based and reflect additional taxpayer costs. With over $1.2 trillion of insurance exposure in force at the end of 2009, the NFIP needs to have adequate premiums to reflect not only typical year costs, but also potential catastrophic losses, i.e., the probable maximum loss (PML), and capital costs.

Additionally, following the passage of the Flood Insurance Reform Act (FIRA) in 2004, significant improvements were made by the NFIP to its claims appeals process that makes provisions establishing a NFIP ombudsman duplicative and unnecessary. Changes in the maximum amount of coverage available should also be reconsidered as they have not been indexed or adjusted since 1994. And lastly, the mandatory purchase requirement should be strengthened to ensure that those who need the product actually purchase it, hence minimizing the potential taxpayer impact when the next event occurs.

Multiple-Peril Coverage – H.R. 1264

Some have suggested that the NFIP, which already suffers under crushing debt and falls well short of actuarially sound flood underwriting and premium rates, should be expanded to cover windstorm risks. Along with numerous environmental, consumer, budget, and other non-insurance associations, the WYO Flood Insurance Coalition opposes expanding the Program and believes that there are alternative approaches to address problems associated with windstorm coverage. Our industry supports more narrowly targeted legislative and regulatory solutions that address specific problems and concerns without a vast and unnecessary expansion of a government program that is already in debt and in need of return to financial stability.

Impact on the Economy and Affordability of Coverage

Adding wind coverage to the NFIP could have the following consequences:

- According to a study done by Tillinghast, Towers Perrin, if only 20 percent of the property marketplace purchases the NFIP multiple-peril (flood and windstorm) policy, potential losses could total from just over $4 billion to $78 billion, depending on the size and location of a catastrophic event.
- According to a Property Casualty Insurers Association of America (PCI) analysis, federal control of wind insurance policies would result in about 41,775 jobs being eliminated throughout the country. This reduction in workforce translates into $2.6 billion in lost wages that would be removed from the economy.
- Such a program could also mean a loss of more than $26.9 billion in private industry insurance premiums. Insurers must invest premiums to build capital and surplus to cover insured losses. Further, since insurers are strong investors in municipal, state and local bonds, this loss of revenue could result in a loss of more than $20.48 billion in bond investments.

- The loss of revenue from such a market displacement would further result in more than $810 million in lost state premium tax revenue and more than $780 million in individual state and federal income tax revenues.
- Irreparable damage to the private coastal insurance market would also result from such a program being put in place. Small or start-up companies, particularly in Florida and Louisiana, that voluntarily assume policies from the state-run insurance plans, would be put out of business. In Florida alone these companies account for over 28 percent of the property insurance market and $1.9 billion in premiums.
- Instead of spreading risk globally through private reinsurance, risk would be transferred to a smaller region of U.S. taxpayers, and the private reinsurance capital base would subsequently decline affecting other insurance markets across the country.

While constituents may state that they cannot get wind coverage, they may mean that they could not find wind coverage at a price that they want to pay. This has been the experience of the state government-run earthquake insurance program in California (the California Earthquake Authority) where take-up rates hover around 15 percent. Excessive government involvement in a private sector industry may shift costs from pre-funded private capital to post-funded taxpayer capital (which as we are seeing now with the NFIP is a cost-hiding, not a cost-savings), but it results in numerous indirect costs including loss of tax revenue, greater political interference in rate setting, and private job losses.

Here the government has two choices: (1) take over the wind insurance market, which could artificially lower the price of coverage for some, with the potential for enormous costs to all taxpayers, significant damage to the private sector, and a massive cross-subsidy from Americans who do not live in coastal zones; or (2) leave wind coverage to the private and state markets and consider more narrowly targeted solutions, including providing subsidies to individuals who truly cannot afford the risk-based costs of insurance.

Fidelity National and the WYO Flood Insurance Coalition strongly support the latter option. Given the current economic climate, the timing could not be worse to eliminate private investment in the insurance market and to destroy private sector jobs. Instead, Congress could consider giving the small percentage of low-income coastal citizens who truly cannot afford their wind insurance premiums a subsidy that would be phased out over time. Such subsidies should be transparent and outside of the insurance system, so risk-based pricing is not distorted. Destroying the current system would essentially give the entire coastal community a taxpayer subsidy.

Availability

There is sometimes a misperception that windstorm coverage is not available in coastal areas. In fact, every homeowner can find windstorm coverage either through the private market or a state residual market plan. Every large coastal state has a residual market mechanism in place to assure the availability of windstorm coverage, and coverage is available through these entities to more than 99 percent of the properties along the coasts. Only properties in significant disrepair are uninsurable through these programs. The following describes existing state residual market mechanisms:

1. A Fair Access to Insurance Requirements (FAIR) Plan (a program also established by federal law in 1968) has been enacted in California, Connecticut, Delaware, the District of Columbia, Georgia, Hawaii, Maryland, Massachusetts, Mississippi, New Jersey, New York, North Carolina, Oregon, Rhode Island, Texas, Virginia, and Washington.
2. A "windstorm" or "beach" program designed specifically to provide windstorm coverage has been established in Alabama, Mississippi, North Carolina, South Carolina, and Texas.
3. Both Florida and Louisiana have a Citizens Property Insurance Corporation (combination windstorm and FAIR Plan entity).

Wind vs. Water

Proponents of H.R. 1264 have stated that adding wind coverage to the NFIP will eliminate policyholder concerns over whether or not, or how, their claims will be covered under the NFIP and their separate windstorm coverage. In fact, the bill would still require a determination of cause of loss (since the wind and flood perils are separate, with separate premiums). Further, private insurers may write "excess" windstorm coverage (or perhaps excess flood coverage) and determining the appropriate relationship between the amounts covered by each peril may determine how much is paid under this scenario as well.

GAO Report

The GAO issued a report (GAO-08-504) in April 2008 that looked specifically at the issue of expanding the NFIP to include windstorm coverage. The report states that expanding the NFIP would require FEMA to address a number of significant challenges including: (1) determining wind hazard prevention standards; (2) adapting existing programs to accommodate the risk; (3) creating new rate-setting processes; (4) promoting the new program; and (5) staffing and administering the program.

The report also states that even if all these issues were addressed there would still be significant obstacles in establishing such a program. It concludes that "an unknown portion of exposure currently held by state wind programs – nearly $600 billion in 2007 – could be transferred to the federal government." It also indicates that the program would have trouble setting appropriate rates; therefore "the potential exists for losses to greatly exceed expectations...which could further increase FEMA's debt."

Summary of the Perils of Expanding the NFIP

The WYO Flood Insurance Coalition believes that expansion of the NFIP to include a multiple-peril policy to provide coverage for both flood and windstorm loss is ill-advised and would:

- Significantly displace the private market that continues to provide the majority of the windstorm coverage in coastal states, and all of the wind coverage in inland states;
- Disrupt the various long-standing state residual market mechanisms established for the purpose of providing such protection in these catastrophe-prone areas;
- Ultimately be inadequately priced, leading to a further government subsidy of a product widely available in the private marketplace; and
- Create a significant burden on U.S. taxpayers.

Although we recognize that NFIP expansion proposals are prompted by perceived problems in settling claims as between flood and windstorm coverage, current private and federal insurance contracts clearly include three avenues for appeal for consumers who are dissatisfied with their claim settlement. Consumers may: (1) request an appraisal; (2) file an appeal with the NFIP; or, (3) as a last resort, turn to the court system.

For these reasons, Fidelity and the WYO Flood Insurance Coalition urge you not to expand the NFIP to include a multiple-peril policy program in the NFIP reform/reauthorization legislation.

Conclusion

On behalf of Fidelity National and the WYO Flood Insurance Coalition, thank you for the opportunity to present our views today. We look forward to working with you to protect consumers and reform and improve the National Flood Insurance Program.

Testimony

of

Craig Fugate

Administrator

Federal Emergency Management Agency
Department of Homeland Security

on

The National Flood Insurance Program

Before the

House Committee on Financial Services,
Subcommittee on Housing and Community Opportunity
U.S. House of Representatives
Washington, DC

April 21, 2010

Introduction

Good afternoon Chairwoman Waters, Ranking Member Moore-Capito, and distinguished Members of the Subcommittee. It is my privilege to appear before you today on behalf of the Department of Homeland Security and the Federal Emergency Management Agency (FEMA) to discuss the National Flood Insurance Program (NFIP).

As the Subcommittee continues the process of reauthorizing this program, it is important that we first look at the original intent and purpose of the NFIP. When Congress created NFIP 42 years ago, the nation had just experienced a series of deadly and costly natural disasters. We needed to address the escalating costs of flooding associated with these disasters, and we needed to provide financial relief to those who were most at-risk for flooding. We recognized, however, that the private sector insurance market was not able to provide a vehicle for insuring these properties.

With these concerns in mind, Congress passed the National Flood Insurance Act of 1968 and established NFIP. The program was created to:

- Protect communities from flood damage through state and community floodplain management regulations;
- Provide our citizens with affordable flood insurance to better indemnify property at risk to flooding; and
- Reduce the financial burden on the federal government for disaster assistance.

While the principles of NFIP are straightforward, its implementation is more difficult—an effective flood management strategy requires that every homeowner at risk of flooding participate in the National Flood Insurance Program and purchase flood insurance.

Challenges to Managing the National Flood Insurance Program.

Over the last decade, the federal government has undertaken a comprehensive update of flood maps. This effort was widely supported by all levels of government, citizens and the private sector, as better information would be available to understand our risks for flooding and other disasters.

Though these maps are generally well-received and provide better information, they do have financial consequences. Lenders require that individuals who are mapped into the Special Flood Hazard Area (SFHA) purchase insurance; although we empathize with individuals who face financial hardship and cannot afford to purchase flood insurance, we are bound by the laws that govern the program. At my direction, FEMA staff has searched for ways to exercise the maximum amount of flexibility as allowed by the statute. We have explored strategies that would ease the financial burden on individuals who have been newly mapped into the SFHA, and we continue to work with communities that have a definitive plan to repair their levees.

While much has changed in the 42 years since Congress created the NFIP, the basic need for a fiscally sound and comprehensive flood management strategy has not. As Congress considers reform for the program, we offer several issues for your consideration.

First, we need to look at risk holistically for the entire hydrological cycle, understanding that we have to manage water as a resource. Second, development in high-risk areas is not managed by the federal government; use is managed locally, and decisions to build in those areas should be accompanied by paying for appropriate risks. We need to develop solutions for those that already live in high-risk areas and ensure that appropriate insurance coverage continues to be available. Third, we have to find better ways to communicate risk; in particular, we need to explain to ordinary citizens what a 100-year flood plain and a 500-year flood plain mean in terms of their actual risk.

Fiscal Challenges Now Facing the National Flood Insurance Program

One of the major challenges we now face is finding a way to alleviate the program's current debt burden. Hurricanes Katrina, Rita and Wilma drove $18.7 billion in debt to the Treasury. Since fiscal year 2007, we have paid approximately $2.4 billion in interest on the debt. While we have been able to pay off nearly $600 million in principal during 2008 and 2009, extremely mild hurricane seasons and current low interest rates will not continue indefinitely. It is unlikely that we will ever retire this debt, and we continue to pursue debt forgiveness. The program's borrowing authority is currently capped at $20.775 billion, and the $2.075 billion that the Program is authorized to borrow before reaching that cap should be sufficient to address the program's needs for fiscal year 2010 provided there is no catastrophic flood event.

The Subcommittee will hear testimony today about H.R. 1264, the Multi-Peril Insurance Act. This bill would amend the National Flood Insurance Act of 1968 to allow for the purchase of multi-peril coverage and optional separate windstorm coverage. We are concerned that under a multi-peril federal program, the liability for multi-peril insurance, which is currently absorbed by the private property insurance market, would be transferred to the U.S. Treasury and, ultimately, to the American taxpayer.

Notwithstanding the bill's language, a Federal program will face pressures to set aside risk-based pricing and offer subsidized government insurance. If it lowered insurance prices below the actuarially-fair value, a Federal program would encourage people to take on more risk than if they faced the full expected costs of damages. In addition to the riskier behavior, Federal Government participation in the wind insurance market would displace private markets, and mandate an unfair cross-subsidy burden on taxpayers.

FEMA's Efforts to Improve and Strengthen the National Flood Insurance Program

In the past two decades, FEMA has engaged in a number of efforts to solicit valuable input on how the NFIP should be improved. In 1998, FEMA gathered input from a wide array of stakeholders that culminated in the June 2000 report, "Call for Issues, Status Report."

Shortly thereafter, FEMA solicited the assistance of the American Institute for Research. Between 2001 and 2006, the Institute conducted an evaluation of the NFIP and ultimately prepared a series of detailed reports that helped further develop the program so that it would continue to meet the needs of the public and fulfill its Congressional mandate to reduce federal expenditures for disaster assistance and flood control.

NFIP Reform Working Group
In anticipation of the upcoming reauthorization of the NFIP, I established an internal NFIP Working Group to develop policy recommendations for comprehensive reform.

Phase I of that effort began with an NFIP Listening Session, which took place in Washington, D.C., last November. Nearly 180 participants, representing a broad spectrum of program stakeholders, including Federal, state, local and tribal governments; associations, non-profits and the private sector, were given the chance to have their opinions heard. The listening session was designed to engage our partners, stakeholders and customers, hear their perspectives concerning the key issues facing the program, identify where there is common understanding and document the diversity of opinions concerning the optimum implementation of the NFIP. The Phase I Final Report, entitled "NFIP Stakeholder Listening Session: Findings and Next Steps," has recently been released.

We are now conducting Phase II of the effort, which is a thorough analysis of the feedback that we have received. In addition to conducting an in-depth analysis of comments we received during the NFIP Listening Session, we will also reexamine findings and recommendations received in the 2006 American Institute for Research NFIP Evaluation Report, as well as the Call for Issues: Status Report published in 2000. During Phase III FEMA will begin the process of finalizing options for consideration in the development of an Administration approach to NFIP reform which we will share with the committee when completed.

We are also working closely with the Government Accountability Office (GAO) to resolve issues associated with the GAO's high-risk designation of the Program. In 2006, GAO placed the NFIP on its High-Risk List and stated that comprehensive reform was necessary. I have asked FEMA staff to work closely with GAO to identify actions that can be taken immediately to resolve some of these issues. GAO is currently reviewing the oversight and management of the NFIP to include how FEMA manages contracts, personnel, finances, and information technology assets associated with the program. I know FEMA can improve the oversight and management of the NFIP from an internal perspective. To improve the guidance the NFIP and other FEMA programs receive, I have reorganized the administrative and management organizations in the agency and placed them under the Mission Support Bureau, headed by a highly experienced Senior Executive Service manager.

Flood Insurance Rate Maps
In fiscal year 2003, FEMA began to digitize and update its flood insurance rate maps. Many of these maps were 20-30 years old and no longer accurately reflected flooding hazards. At the close of fiscal year 2009, FEMA had issued modernized flood insurance rate maps in preliminary format for over 80 percent of the nation's population in approximately 13,000 communities, and approximately three quarters have now been finalized (covering more than 60 percent of the nation's population in about 7,700 communities). While we have seen an overall increase in the size of the SFHA by roughly 7 percent nationwide, we have also seen an approximate 1 percent net decrease in the number of housing units located within SFHA.

We are committed to finishing this important work. By the end of fiscal year 2010, we expect to have preliminary flood insurance rate maps issued for over 90 percent of the nation's population. Further, as draft maps are released, we will continue to provide ample opportunity for the public to comment before they are finalized.

Efforts to Increase Awareness and Community Participation

Like any insurance pool, expanding the risk pool is important for the NFIP. Mandatory purchase of flood insurance is required for mortgage holders in a flood plain in order to obtain a mortgage. However, many people do not know that they can purchase flood insurance even if they are not in a flood plain. As such, we are committed to an annual objective of five percent net growth in the number of NFIP policies in force. We are evaluating several strategies to reach this goal, which are under development:

- FEMA tries to reach the lending institutions that mandate insurance coverage on mortgages. We provide a great deal of technical assistance to regulators and lenders through training sessions, guidance materials and regular communication with federal lending regulators, Government Sponsored Enterprises, federal agency lenders, and the lending community.

- We continue to improve and extend the reach of the NFIP's national marketing, advertising and public awareness campaign, *FloodSmart*. This campaign uses television, radio, print and online advertising, direct mailings and public relations activities to inform consumers about the risk of flooding, as well as the availability and benefits of flood insurance. These communications drive homeowners, renters and businesses to call their own flood insurance agents, call FEMA's toll-free referral center for more information, or visit FloodSmart.gov, where they can assess their risk, estimate their premiums and locate agents in their areas (as well as use tools such as the Cost of Flooding, Flood Risk Scenarios and current mapping status updates).

- We continue to improve insurance agents' understanding of the NFIP by providing both web- and classroom-based training. This spring, we are launching a professional flood insurance designation program for insurance and other professionals whereby practitioners that pass three exams can earn the Associate in National Flood Insurance designation from the American Institute for Chartered Property Casualty Underwriters.

- Lastly, our strategy to increase participation in the NFIP includes promotion of the Community Rating System (CRS). The CRS is a voluntary program that provides flood insurance premium discounts to policyholders in communities that adopt and enforce floodplain management programs with standards that exceed NFIP minimums. The CRS includes 10 rating classes providing successively greater insurance premium discounts, based upon the floodplain management practices of a community. The NFIP had 31 new communities join the CRS in fiscal year 2009, raising the total number of CRS communities to 1,110 last fiscal year. The Program also had 89 CRS communities achieve class improvements, thereby qualifying policyholders for additional flood insurance discounts.

NFIP Enrollments have increased significantly over the last few years. Currently, over 21,000 communities participate in the NFIP. FEMA enrolled 467 new communities in FY09, 424 new enrollees in FY08 and 233 new enrollees in FY2007.

Conclusion

We learned two very valuable things from the listening sessions. First and foremost, we learned that the NFIP still provides an essential service to the American people that would be otherwise unavailable or unaffordable. Second, we confirmed that the NFIP requires meaningful reform.

We were reminded of the importance of the NFIP when the program's authority expired briefly in March and again in April. With the lapse in authority, new flood insurance policies could not be written, leading to the possible delay of thousands of citizens seeking mortgage loans that require flood insurance as a precondition to settlement. Although regulators overseeing the lending industry have not precluded loans being made in cases when flood insurance is unavailable, lenders are encouraged to carefully evaluate their risks. As flood insurance policies expire, they cannot be renewed and claims cannot be paid on these policies. In the event of a flood, policyholders unable to renew their policies will face the financial consequences either on their own or with very limited federal disaster assistance if the President issues a disaster declaration. While the program needs longer-term reform, shorter terms lapses in the NFIP's authorization could be costly. Citizens rely on this program to give them access to insurance for flooding—there is no other effective private or public sector backstop to assist people in repairing property and recovering a flood event.

The work we have to do to comprehensively reform the NFIP is considerable. This program provides a financial backstop for millions of citizens, while at the same time reducing disaster assistance expenditures. We look forward to continuing to work with the Subcommittee to provide a long-term reauthorization and comprehensive reform. I would be happy to answer any questions you may have.

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Testimony

Flood Insurance Reform and Reauthorization

Before the Subcommittee on Housing and Community Opportunity
House Committee on Financial Services

Larry Larson, P.E., CFM, Executive Director
Association of State Floodplain Managers

April 21, 2010

Overview

The Association of State Floodplain Managers (ASFPM) thanks this Subcommittee, Chairwoman Waters, Ranking Member Capito and members of the Subcommittee for your attention to the need to reform the NFIP. We very much appreciate your holding this hearing and planned mark-up tomorrow. Unfortunately, the extensive work that went into the Flood Insurance Reform Act, passed in different forms in the 110th Congress by both the House and Senate did not result in new public law. Many of the elements of that legislation are still highly relevant and in need of resurrection. Beyond that, some other issues have emerged that point to the need for further reform ideas.

Who We Are

The Association of State Floodplain Managers, Inc. (ASFPM) and its 29 Chapters represent over 14,000 state and local officials and other professionals who are engaged in all aspects of floodplain management and hazard mitigation, including management, mapping, engineering, planning, community development, hydrology, forecasting, emergency response, water resources, and insurance for flood risk. All ASFPM members are concerned with working to reduce our Nation's flood-related losses. Our state and local officials are the federal government's partners in implementing flood mitigation programs and working to achieve effectiveness in meeting our shared objectives. Many of our state members are designated by their governors to coordinate and implement the National Flood Insurance Program, and many others are involved in the administration and implementation of FEMA's mitigation programs. For more information on the Association, our website is: http://www.floods.org.

A Comprehensive Review of National Flood Insurance Program Accomplishments and Shortfalls is Needed for Long-Term Reform

ASFPM applauds the constructive examination of the National Flood Insurance Program (NFIP) launched by FEMA Administrator Craig Fugate. Administrator Fugate has recognized both the value of the NFIP and the need for a new phase of program growth and adaptation to changing circumstances. During a Listening Session on the future of the NFIP last November, Mr. Fugate challenged over one hundred invited participants to think creatively about the overall value of the NFIP, what it was intended to achieve, what is has and has not accomplished, and needed changes, both small and large. [1] One example to encourage thinking big was whether or not the private sector could now handle and provide flood insurance. Mr. Fugate has subsequently charged a FEMA working group with assembling the recommendations, analyzing their merits and feasibility, and then developing substantive recommendations for moving the NFIP forward. The working group will evaluate not only the suggestions from the recent and additional Listening Sessions, but also the recommendations of a multi-year NFIP Evaluation led by the American Institutes for Research, the results of several Government Accountability Office

[1] *ASFPM comments at the NFIP listening session appended to this testimony*

Studies, Congressional Research Service studies, and other reports. FEMA expects to have a number of substantive additional reform proposals ready for Congressional consideration within the next two years, when we urge your timely consideration.

The NFIP Challenges for Growth and Adaptation

The hurricane seasons of 2004 and 2005 involved catastrophic losses well exceeding the average historical loss year, putting the program in debt to the Treasury. The debt now stands at $18.7 billion. Due to two mild loss seasons and a favorable refinancing of the debt, the NFIP has been able to repay $589 million and the interest. However, full repayment of the debt is not a reasonable expectation because mild loss seasons cannot be expected to continue, the nation's flood risk is increasing due to development and more intense storms, the interest on the debt will go up, and the annual program income is about $3.2 billion.

The poor condition of much of the nation's infrastructure, including levees, dams and other flood control structures, as well as stormwater facilities, has become more evident. More accurate flood maps now reflect the unreliable flood protection of levees and the effects of development by showing some areas as now in the 100-year flood hazard area (and, conversely, by showing many areas as no longer in the 100-year flood hazard areas). It is important to note that almost as many properties are newly shown as <u>out</u> of a Special Flood Hazard Area (SFHA) as are newly shown as <u>in</u> the SHFA. Requirements for the purchase of flood insurance in areas newly shown as at risk of flooding are highlighting concerns about affordability of flood insurance.

Reflections and Questions

The Association of State Floodplain Managers concludes that the NFIP has been successful in meeting a number of its original objectives, but less so in reducing flood losses in the nation. The NFIP has, for example, required those living at risk to obtain flood insurance, sparing taxpayers from paying many millions of dollars in disaster relief, and enabling many citizens to more fully restore their lives to normalcy after a disaster. Additionally, the NFIP has prevented some unwise development and promoted some hazard mitigation through local adoption of floodplain management ordinances. On the other hand, too many Americans continue to build in at-risk locations, including residual risk areas behind flood control structures, and collective flood losses for the nation continue to increase in real dollars. In the first decade of this century, yearly flood losses have increased from $6 billion to 15 billion.

We recommend that Congress consider clarifying the intended objectives of the NFIP so that the program can be evaluated accordingly. For example, should the NFIP be expected to accommodate catastrophic losses rather than the average historical loss year? If so, are there realistic, affordable program adaptations that can achieve that objective? If not, would it be best to clarify that the program is not expected to cover truly catastrophic losses?

Other questions warrant examination. What adjustments are needed for the program to be a positive factor in reducing flood losses in the nation? What adjustments are needed to act on better risk identification through improved maps? If the NFIP is to be a significant tool in an integrated flood risk management approach, how should it be altered to better support this objective? ASFPM has endorsed the following concepts:

- Integrate the NFIP with other federal flood risk programs, including the disaster relief program Army Corps of Engineers, Environmental Protection Agency (EPA) and Natural Resources Conservation Service. (NRCS)
- Identify cross-program policy conflicts and inappropriate incentives that increase risk.
- Build State floodplain management program capability and capacity to work with the 21,000 participating local jurisdictions
- Delegate the floodplain management and mapping elements of the program to qualified states, similar to programs managed by the EPA and Department of Transportation.
- Identify incentives and disincentives for state and local governments to make the program more effective, since local decisions determine how much development will be placed at risk of flooding.
- Evaluate the NFIP-funded mitigation grant programs to determine whether they are effectively addressing the most high-risk structures.

Should the flood maps better display the flood risk so that communities and citizens understand that the flood risk does not stop at the line on a map – and that considerable risk exists beyond the "100-year" floodplain? (The average home is occupied for more than 100 years, virtually assuring that every home in the 100-year flood hazard area will flood in its lifetime.) Should insurance be required in residual risk areas behind levees and below dams? Should insurance be required in a broader area, such as the 200-year or 500-year floodplain? Should critical infrastructure like hospitals, fire and police stations and water supply and treatment plants be regulated based on a larger flood, but one the nation experiences somewhere every year, such as the 500-year floodplain? Should flood insurance policies be long-term (20 years or more) and tied not to the owner but to the property, regardless of property transfers?

Broad Recommendations

Flood insurance should gradually move toward being actuarially sound to reflect actual risk and enable market-based financial decisions about how much risk-related cost to assume. We recognize that there are affordability problems for some citizens living in at-risk areas; this is more prevalent in older riverine areas than in recently developed coastal areas or some newly developed areas behind levees. The de-accreditation of levees and more accurate flood maps have highlighted the affordability issue. We do not support efforts to delay issuance of flood maps, withholding accurate information about flood risk from citizens living and working in hazardous areas. We suggest that this issue presents challenges, but ones that can lead to constructive new growth and adaptation for the NFIP if done correctly.

To actually reduce flood-related loss of life and property in the nation, we must move toward a true flood risk management framework with the nation's policies and programs. A comprehensive flood risk management program recognizes that:

- Managing flood risk is a shared responsibility between individual, private sector, community, state and federal government;
- Flood risk is not isolated to the 100-flood hazard area but is rather a continuum of risk that crosses lines on a map;
- Development and other activity outside the 100-year floodplain impacts flood levels—if we only manage activity in that 100-year floodplain, we miss opportunities to save lives and reduce flood damages and impacts;
- All structural protection measures will fail or be overtopped at some point by some flood event;
- Managing flood risk requires a mix of measures from structures to avoidance to retreat from high risk areas. Selection of only one structural measure, such as a levee, leads to severe losses in catastrophic events. Levee failure and high storm surge and 500-year events have shown the need for a mix of approaches including elevation, insurance and structures;
- Flood levels will increase in the future because development increases runoff; and storms are intensifying;
- Flood risk will increase as the natural resources and functions of floodplains are altered by development since this destroys the natural system that reduces the negative impacts of flooding;
- Flood risk management includes concepts such as identification of flood risk, community planning to steer development away from areas of risk, basing flood insurance on actual risk, vigorous promotion and support of hazard mitigation actions, and enabling citizens to better recover from disasters by being insured to reduce their financial risk.

The U.S. Army Corps of Engineers has adopted the concept comprehensive flood risk management approach in many of its programs at the national level, but for this approach to be successful for the nation, FEMA must also actively promote the concept and integrate its programs for the NFIP, mitigation and disaster relief internally, and with programs of the Corps and other agencies that impact flood risk.

Consider a number of interesting ideas to address the affordability problem. The long-term goal should be to eliminate premium subsidies: an insurance program with subsidies is not an insurance program. We understand the need to assist low income people with insurance premiums for some specified length of time, upon demonstrated need. A program of flood insurance vouchers to assist with purchase of flood insurance issued through a means-tested program could be administered by the Department of Housing and Urban Development. An analysis might show it would be less costly for the taxpayer to pay for flood insurance vouchers for low income property owners for a limited time rather than have the taxpayer continue to pay disaster costs from the Disaster Relief Fund every time that a community floods. This would also support more rapid post-disaster restoration and community economic stability because everyone would have flood insurance which can also be applied toward mitigation of their property after a disaster. If short-term relief is provided using the NFIP-- through delayed mandatory purchase of insurance, extension of time when policies can carry Preferred Risk rates, or phase-in of actuarial rates; it must be recognized that none of these are appropriate long-term solutions. In conjunction with such short-term relief, FEMA should provide general information about actuarial rates so people see what their true risk is, and at the same time, provide substantial information about mitigation actions and how much each action will reduce actuarial premiums in the future. Group flood insurance could be developed by FEMA for mapped flood hazard areas and areas mapped as protected by a levee, allowing a group policy to be purchased by the levee district or other local taxing entity for all residents of the area, thereby keeping costs down. Remember, the more policies there are the lower the premiums everyone pays.

The nation must carefully balance the issue of who benefits and who pays for development at risk. There are about 130 million housing units in the U.S. Of that about 10 or 11 million are in flood hazard areas. Of those in flood hazard areas, roughly half carry flood insurance. This means 90% of the population does not live in identified Standard Flood Hazard Areas, but continues to pay a large amount each year for disaster relief for flooding, rebuilding damaged infrastructure in flood areas, and may have to cover the $18 billion debt of the NFIP. Yet those same taxpayers obtain few, if any, of the benefits of that development. This points out the need to tie program outcomes of the NFIP to these other programs like disaster relief programs and programs of HUD, DOT, USDA and others.

Perspectives on the National Flood Insurance Program

FEMA reports that the NFIP was been self-supporting for 20 years. From 1986-2005, prior to Hurricane Katrina, income from policyholders covered claims and all operating expenses, including salaries and expenses of the Federal employees who administer the NFIP and floodplain management programs. From time to time the NFIP exercised its authority to borrow from the U.S. Treasury when claims exceeded short-term income. Importantly, the program was praised for its ability to repay debts ahead of schedule and with interest. This would seem to be the way Congress intended the program to function. The original framers did not require the NFIP to set rates for truly catastrophic flooding associated with extreme events like Hurricane Katrina, or to have reserves to cover the fiscal impact such events would have on the program. A significant, often unrecognized, and difficult to measure benefit of the NFIP is the number of decisions people have made to build on higher ground and the damage that doesn't occur because buildings have been built to resist flood damage. Perhaps the original framers considered it reasonable that taxpayers contribute to payment of claims after extreme events that exceed the NFIP's capacity to pay as part of the bargain for long-term overall improvement in the way we manage flood losses—perhaps Congress could clarify this.

The NFIP has multiple goals, and providing flood insurance in order to minimize direct government subsidy of flood damage is one of the goals. The consequence of having fewer people insured against known risks would likely be greater reliance on taxpayer funded disaster assistance and casualty loss tax deductions. Striking the balance between a fiscally sound NFIP while having premiums that are affordable – but that do not reward or encourage development in high flood risk areas – is the challenge now facing Congress and the nation.

The National Flood Insurance Program is now 42 years old. It was created in 1968 by the Congress following several major studies in the 1950s and 60s which concluded that the private sector did not offer insurance coverage for flood because only those who had actually flooded would buy policies, contrary to a normal insurance model which assumes a broad spreading of risk to cover losses. The lack of information showing which properties were likely to flood added to the private sector dilemma, which is less of a challenge now that FEMA produces flood maps for 21,000 communities. The concepts embodied in the NFIP were designed with the idea it would save the taxpayers' money in disaster relief by requiring those living in at-risk locations to pay something to cover their own risk, and to enable them to more fully recover from flood damage than they could with only disaster relief. The assumption was that this would reduce flood losses over time by requiring local regulation of development in flood hazard areas as communities voluntarily agreed to participate in the program in order to make flood insurance available to community residents and businesses.

The NFIP has gone through various stages of growth and adaptation involving more, then less, then again more involvement with private insurance companies and agents. After its first five years, Congress added mandatory purchase of flood insurance in identified flood hazard areas. By 1979, the program moved from the Department of Housing and Urban Development (HUD) to the newly established Federal Emergency Management Agency (FEMA). Initially some 70% of insured properties had discounted policies because they were "grandfathered" since they were built before the flood hazard area was identified. Now about 23% of insured properties have these discounted rates. Many newly developed properties have been built either in safer locations outside the 100-year floodplain or built to NFIP standards (elevated to the 100-year flood level) to mitigate possible flood losses.

During the 1980s, the goal of making the program self-supporting for the average historical loss year was achieved, but the premiums did not provide sufficient income to develop and maintain accurate flood maps for 21,000 communities. There were no Congressional appropriations for the program from 1986 until 2003, when it was agreed the nation needed a major map modernization effort requiring appropriated funds. Most of the nation's flood maps were found to be 10 to 20 years old, not reflective of massive watershed and floodplain development, and therefore not accurately representative of actual flood hazards.

A major report following the mid-west floods of 1993 found that only 10-15% of damaged properties had flood insurance. This led to another set of improvements in the National Flood Insurance Reform Act of 1994, including stricter compliance requirements for lenders and new means of encouraging and supporting mitigation through the Increased Cost of Compliance insurance coverage, establishment of the Flood Mitigation Assistance program and authorization of the Community Rating System to make lower premiums available in communities taking significant steps beyond national minimum approaches to mitigate risk. The Flood Insurance Reform Act of 2004 Act made a number of improvements to insurance agent training and consumer provisions, and enhanced and developed programs to address the problem of repetitive flood losses.

Comments on the Discussion Draft

The draft flood insurance reform bill makes some important improvements, but neglects others, some of which were included in the flood insurance reform legislation that passed the House in the previous Congress. We offer general comments on several major issues, comments on specific provisions that are missing, and comments on several provisions of the draft bill.

Reauthorization for 3 Years

Due to the recognition that FEMA is in the process of analysis and development of significant recommendations for the future of the NFIP, ASFPM urges that the NFIP be authorized for no longer than 3 years. This would provide program stability while anticipating further recommendations for program growth and adaptation. We stress this point because the issues highlighted by the concerns about risk identification and flood insurance affordability require more substantial program revisions than can be considered in a short period of time.

Debt to the Treasury

As noted above in this testimony, the NFIP was self-supporting from 1986 until 2005 when the catastrophic losses from the 2004 hurricane season in Florida and Hurricanes Katrina, Rita, and Wilma in 2005 generated the current debt to the Treasury of $18.7 billion. Given that the annual NFIP income is about $3.2 billion, that the past few years have been mild loss years and that interest rates can be expected to rise, it is unreasonable to expect the debt to be fully repaid. Balancing affordability of flood insurance and its role in building the policyholder base with premium rate increases as high as the 20% per year suggested in the draft bill requires careful consideration. ASFPM supports an increase from the current 10% cap to a 15% cap, but suggests some analysis is needed about where the balance should be. The debt arising from the 2004-2005 hurricane seasons should be considered emergency funding and the debt forgiven since the NFIP has successfully been self-supporting for the average historical loss year. The flood insurance reform bill should address the NFIP debt to the Treasury.

Separation of Congressional Committee Jurisdiction

ASFPM understands that consideration is being given to dividing Congressional committee jurisdiction over the NFIP between the House Financial Services Committee and the House Transportation and Infrastructure Committee. The idea, as we understand it, would leave the insurance aspects of the program with the House Financial Services Committee, while transferring the mapping, land use and flood risk mitigation elements to the Transportation and Infrastructure Committee.

ASFPM opposes such a division of committee jurisdiction. The program is often referred to as a three-legged stool: insurance, risk identification and mitigation. Proposed short-term solutions to the issues associated with better risk identification (Flood Mapping) all involve adjustments to the insurance rate structure and timing. As the Map Modernization initiative draws to a close in 2010, the new Risk MAP program is intended to draw better connections between risk identification, mitigation and insurance, risk assessment and community hazard mitigation planning. It involves a substantially improved outreach effort to better inform communities and their citizens about their flood risk and the importance of insurance to community resilience. To separate committee jurisdictions over the NFIP would create an artificial division of a program that was creatively designed to function as a whole.

Lack of Mapping Section

ASFPM is very disappointed to note that the draft bill contains no section to authorize the ongoing risk identification work of the Federal Emergency Management Agency (FEMA). The flood insurance reform bills passed by both the House and Senate in the 110th Congress (but not enacted), contained substantial sections providing for ongoing and expanded mapping activities. Both bills re-established a Technical Mapping Advisory Council in FEMA to bring in the knowledge and experience of a number of expert stakeholder groups. Risk identification is central to understanding where the risk is, how to mitigate risk and reduce loss of life and property, and where to require insurance that will facilitate disaster recovery. The flood insurance program cannot function properly without up-to-date and accurate data on flood risk. This is another example of the integration of the three legged stool elements of the NFIP and is a serious omission from this draft legislation.

Wind and Flood – Multi-Peril Insurance

The ASFPM has testified in the past to voice its strong opposition to proposals that would add the unknown exposure of an optional wind and flood policy to the NFIP. While intended to benefit the narrow strip of properties subject to both hurricane storm surge and wind damage, this proposed policy change could conceivably result in coverage of a property in a flood zone that was destroyed by winds elsewhere in the nation. While it is true that many Americans live in coastal counties, relatively few of those are subject to both storm surge and wind damage, so this concept would involve a major cross subsidy of a small group at risk of both wind and flood damage by policy holders throughout the nation.

Provisions that are Missing from the Discussion Draft:

A number of adjustments that were passed by the House in H.R. 3121, 110th Congress, are missing from the discussion draft. ASFPM urges the subcommittee to include the following.

Flood Mitigation Assistance Program [Section 1366 of the National Flood Insurance Act of 1968 (42 U.S.C. 4104c)]:

- Add "demolition and rebuilding" as an eligible activity; this not only achieves consistency with the NFIP-funded Severe Repetitive Loss grant program, but gives another option that makes sense in certain situations (areas other than high-risk storm surge and floodway areas). Specifically, for some communities, acquisition by fee simple acquisition of land and relocation of the residents may not be the best solution, but rather mitigation measures that help improve livability and community integrity may be. Elevation-in-place is a feasible measure for many buildings; however, for many older buildings and certain types of buildings, it is more feasible or cost-effective to demolish and rebuild a new building, as long as sustainability and resilience are assured along with full compliance with floodplain requirements and building codes which address fire resistance, energy efficiency, and where appropriate, resistance to other hazards such as hail, high winds, and seismic forces.
- Eliminate the limitation on aggregate amount of insurance by striking subsection (f).

- Specify that the funds for this program (Section 1367) shall be available until expended (currently FEMA imposes a 2-year limitation) and that the funds shall be made available without offsetting collections through premium rates for flood insurance.

Severe Repetitive Loss Grant Program [Section 1361A (42 U.S.C. 4102A]:

- Correct an oversight and modify the definition of "severe repetitive loss property" to include nonresidential properties that have received the same number and value of claims. Nonresidential properties make up a disproportionately large share of all repetitive loss properties and we must be able to pursue mitigation of these high-loss properties in order to more effectively stem the drain on the Fund that is associated with properties that receive multiple claims.
- Delete 1361 A(g)(3)(A) and (B) so that the purchase price offered would be determined only by the either the fair market value immediately before the most recent flood event or the current fair market value. It is complicated, confusing, and expensive to have to determine the potential purchase price four ways (and the purpose of the grant is not to enrich those who unwisely paid more than a property's market value at the time of purchase or who borrowed more than the property is worth).

Grants for Direct Funding of Mitigation Activities for Individual Repetitive Claims Properties [Section 1323 of the National Flood Insurance Reform Act of 1968]. Current NFIP-supported mitigation grant programs provide cost share funds to communities – and thus successful projects depend on community participation. ASFPM has long supported community-based mitigation; however, we recognize that some repetitive loss properties are in communities that may not have the resources to participate. In order to achieve the goal of reducing the repetitive loss drain on the National Flood Insurance Fund, we urge the subcommittee to:

- Clarify that FEMA has the authority to work directly with certain property owners under this specific program, which was authorized at $10 million each year. There are many nonresidential properties that have received millions in flood insurance claims. Allowing FEMA to selectively encourage very high-loss property owners to consider mitigation will actually implement paragraph (b) which calls for prioritizing the worst-case properties to result in the greatest savings to the Fund.
- Specify that at least two claims shall have been paid in order for a property to be eligible.
- Specify that the funds shall be made available until expended (see Section 1310(a)).

The following also comes from our recommendations on S2284

Create a New Section to Establish Priorities for NFIP-Funded Mitigation Grant Programs. Direct FEMA to develop a mechanism to recognize that mitigation of repetitive loss properties (of which Severe Repetitive Loss properties are a subset), and that mitigation by acquisition, are priorities. The former helps reduce the drain represented by properties that receive repetitive claims; the latter is the only mitigation activity that permanently avoids future damage, while also providing benefits that are difficult if not impossible to quantify. There are examples where FEMA has denied funding for homes that have a computed benefit to cost ratio of 0.99. We appreciate that FEMA has been criticized in the past for its policy of approving buyouts for homes when the B:C is "close" to 1.0. The required new section would fulfill Congressional intent and make implementation easier and more consistent. It should also be clarified that mitigation projects that include repetitive loss properties and SRLs are, by definition, in the best interests of the NFIP and therefore FEMA should develop a mechanism to recognize this. Report language can suggest that FEMA use multipliers applied to the computed benefit-to-cost ratios as proxies.

Create a new section as follows:
Sec. 1366A. (a) PRIORITIES FOR MITIGATION ASSISTANCE.—In the administration of the mitigation assistance in Sec. 1323, Sec. 1361A, and Sec. 1366, and notwithstanding the provisions of those sections, the Director shall consider the following to be priorities and in the best interests of the National Flood Insurance Fund:

(1) mitigation activities that include repetitive loss structures, as defined in Sec. 1370(a); and

(2) mitigation activities that include severe repetitive loss structures, as defined in Sec. 1361A; and

(3) mitigation activities that include substantially damaged properties, as defined in Sec. 1370(a); and

(4) mitigation activities that include acquisition of properties with structures;

(5) mitigation activities that include other such properties as the Director determines are in the best interests of the National Flood Insurance Fund.

(b) RECOGNIZING PRIORITIES.—The Director shall develop a mechanism to recognize explicitly that mitigation activities identified in paragraph (a) are priorities.

Implementation of the Increased Cost of Compliance Coverage as Amended in 2004. ASFPM urges the Committee to request a report from FEMA on implementation of the changes to Section 1304(b) that were enacted in the Reform Act of 2004. This coverage (called ICC) has been part of all policies on buildings in mapped special flood hazard areas since about 1997. Total income associated with premiums for ICC greatly exceed the payments made to qualifying policyholders.

Comments on the Discussion Draft:

Sec. 3. Extension of National Flood Insurance Program. ASFPM urges a 3-year reauthorization of the program and the Severe Repetitive Loss mitigation grant program (see above). To avoid internal conflicts, a conforming amendment to Section 1361A of the National Flood Insurance Act of 1968 is necessary to strike subsection (l), which specifies that the Director may not provide assistance after September 30, 2009.

Sec. 5. Phase-In of Actuarial Rates for Nonresidential Properties and Non-Primary Residences. ASFPM supports movement to actuarial rates for pre-FIRM non- residential buildings and non-primary residences.

Sec. 6. 5-Year Delay in Effective Date of Mandatory Purchase Requirement for New Flood Hazard Areas. ASFPM strongly opposes this provision and urges its deletion in favor of a suggested revision we make below to Sec. 7. Implementing the Section 6 provision leaves property owners vulnerable to a known threat with no recovery mechanism other than federal disaster relief that is capped at $28,000. As a result, community work forces would be far more vulnerable and less able to recover following a disaster. Additionally, implementation of Section 6 would be extremely complicated and costly for FEMA and especially for regulated lenders who would have to create a mechanism to track mortgages on properties in the areas subject to delays and somehow be able to trigger an enforceable contract requirement to obtain flood insurance after the 5-year period expires.

Sec. 7. 5-Year Phase-In of Flood Insurance Rates for Newly Mapped Areas. We oppose this provision as written because implementation would be very complicated. We urge the Committee to examine a proposal that FEMA is developing to extend the Preferred Risk Policy availability for some period of time for properties that are mapped into a flood hazard area by a map revision. The effect would be the same – short-term cost-savings for the policy holder – while being considerably easier for all parties to implement.

Sec. 8. Increase in Annual Limitation on Premium Increases. As noted in the discussion above regarding "Debt to the Treasury," ASFPM recommends considering changing the limit on annual increases to 15 percent which was passed by the House and Senate in the last Congress. The affordability issues would be exacerbated by a 20% cap on annual premium increases as is proposed in the Discussion Draft.

Sec. 9. Consideration of Construction, Reconstruction, and Improvement of Flood Protection Systems in Determination of Flood Insurance Rates. This section offers some relief for communities and property owners behind levee systems that need repair or upgrading. The key to any such short-term relief is that citizen property owners cannot be left vulnerable to economic loss in the event of a levee failure or overtopping. ASFPM accepts this provision as long as it is clear that flood insurance coverage at some rate will be required for some limited specified period of time, after which the levee must meet standards or NFIP requirements will take effect.

Sec. 10. Treatment of Certain Flood Protection Projects. ASFPM opposes this section. It will result in citizens at flood risk being without either protection from a structural measure such as a levee, and without flood insurance. Would Congress really want citizens to have no protection of life, property or their financial well-being, which this may do? The approach in Section 9 provides an acceptable approach to the issue, rather then Section 10.

Sec. 11. Exception to Waiting Period for Effective Date of Policies. We appreciate the flexibility that would make coverage immediately effective if a policy is purchased within 30 days of the purchase or transfer of a property.

Sec. 12. Enforcement. ASFPM supports increasing civil penalties on lending institutions related to administration of the mandatory purchase of flood insurance requirements. We note that the National Flood Insurance Reform Act of 1994 directed that collected penalties are to be deposited into the National Flood Mitigation Fund and made available for grants that mitigate flood losses – another mechanism to improve the financial stability of the NFIP.

Sec. 14. Flood Insurance Outreach Grants. For several years the NFIP has expended considerable financial resources on marketing the NFIP under its FloodSmart initiative. Many states and communities also undertake actions to encourage property owners to understand their risks and to purchase flood insurance. Currently, FEMA is developing what seems to be a robust outreach component of the Risk MAP (Mapping, Assessment, and Planning) Strategy. Rather than require FEMA to spend limited resources to create the framework for a new competitive grant program, ASFPM believes FEMA's attention is best focused on working with its State and local partners to implement outreach under Risk MAP. However, if the Committee retains this section, ASFPM strongly urges that it be modified to include the States, so that outreach campaigns can become a state-local partnership. It can be more efficient to have a statewide outreach campaign that could target multiple communities in high risk areas, especially if one or more individual communities were not interested in taking an active part.

Sec. 16. Authorization of Additional FEMA Staff. The salaries and expenses of a significant number of FEMA staff in the National Office and all ten Regional Offices who are involved with the NFIP are funded by policy service fees that are assessed on every flood insurance policy. As the NFIP policy base grows, and as the NFIP-funded mitigation grant programs are implemented, FEMA needs to be able to expand its staff to support the increased workload.

Sec. 18. Flood Insurance Advocate. This section establishes both a FEMA Headquarters Office of the Flood Insurance Advocate and regional offices, all funded by the NFIP program's revenues. ASFPM much prefers the language passed by the House in H.R. 3121, 110th Congress. That language would have created an Advocate at FEMA Headquarters who was tasked with conducting a study of the nature, scope and extent of policyholder claims issues not being handled adequately by the existing appeals process. This would include analysis of the need for as well as the feasibility and effectiveness of authorizing a larger advocacy presence. The initial idea for a consumer advocate grew out of problems that came to light after Hurricane Isabel in 2003. It is important to note that Sec. 205 of the Flood Insurance Reform Act of 2004 included a provision requiring FEMA to establish a formal appeals process. Surely that process has addressed many of the previously-identified concerns. ASFPM recognizes that consumer protection is important, but urges that the scope of the problem – and the past several years of effort by both the NFIP and the Write Your Own insurance companies – warrant definition.

Sec. 19. Study of Mandatory Purchase for Natural 100-Year Floodplain and Non- Federally Regulated Loans. ASFPM supports broadening the number of property owners who are covered by flood insurance. However, we note that as written, the study called for in this language does not address extending the mandatory purchase requirement into areas that have been called "natural 100-year floodplains" as did language that was passed by the House in H.R. 3121, 110th Congress. These areas have also been called "residual risk" areas. Residual risks are present in areas that would flood if not for the presence of measures such as levees, floodwalls, and flood control dams. Importantly, residual risk areas are at risk of catastrophic flooding when such flood control measures fail. Rather than a study, we urge that the mandatory purchase requirement in "residual risk" areas be implemented immediately, and that FEMA be directed to work with other federal, state and local entities to map such residual risk areas and to establish rates that would reflect actual risk—the greater protection a levee provides, the lower the premium. The land use controls that the NFIP requires communities to administer in the special flood hazard areas shown on Flood Insurance Rate Maps would not be applied to the residual risk areas.

The Association of State Floodplain Managers appreciates the opportunity to share our views, recommendations and concerns with you. We hope these observations, based on our collective experience in working to reduce flood risk in the nation and in serving as FEMA's partners in implementing the National Flood Insurance Program, will be helpful as you work to improve the NFIP. We look forward to answering any questions you may have and assisting the Subcommittee in any way that you find helpful. I can be reached at: (608) 274-0123 or at: larry@floods.org. Our website is: www.floods.org.

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NFIP Listening Session-ASFPM comments
Nov 5-6, 2009

ASFPM Presentation by Larry Larson, ASFPM Executive Director

Now is the time to back up and look at the "big picture of the NFIP"

Various developments have come together to make this a perfect time to open up the thought process about the challenges for National Flood Insurance Program (NFIP) and options to address those challenges. The program is deeply in debt due to catastrophic storms it was not designed to handle; a major effort to modernize and update the nation's very outdated flood hazard maps to be more accurate and appropriately reflect the hazards associated with structures such as levees is changing the delineation of the "regulatory floodplain" and associated areas for mandatory purchase of flood insurance; the need to purchase flood insurance in newly mapped communities is resulting in "push back" against more accurate hazard identification; the public safety communication about risk and hazard mitigation has become lost; and increased enforcement by the Army Corps of Engineers that appropriately results in de-accrediting levees that do not meet the structural, hydrologic, or O&M requirements to assure 100-year flood protection is highlighting the connections between the Corps, FEMA and the NFIP on flood risk management issues.

A new Administration with new thoughts and perspectives is ready to enter the discussion about the NFIP and to advance a more integrated flood risk management strategy where the NFIP is one of the elements therein. ASFPM recognizes not all the ideas we mention here may or after evaluation should be implemented, but all of them should be considered and evaluated to re-tool the NFIP into a more effective program for the nation that will effectively reduce flood losses and the loss of natural resources and functions of our floodplains.

The NFIP has had some major accomplishments in the past 40 years

- Over 20,000 communities with land use mgt and/or building codes (adds resilience)
- Many of nation's floodplains mapped (and much more needed)
- Almost 50% of those are risk of flooding pay at least some of that cost
- The NFIP was mostly self supporting for nearly 20 years

Questions and issues we hope to see addressed

By either FEMA with rules and guidance or by Congress through legislation

What was the NFIP intended to accomplish? Are the goals still valid?
What do Congress and the Administration want it to accomplish?
Does the basis of the NFIP need to change or not?
What's the assessment of what it has accomplished?
Why have flood losses increased, not decreased, despite 40 years of the NFIP?
If it has not succeeded, is it because of program design, inadequate development standards or implementation approaches?

What are recent developments or recognitions that could impact the future of the NFIP?

- Debt to Treasury
- Lack of clarity over whether or not NFIP should cover catastrophic flood losses (the NFIP should not cover wind)
- More severe, intense rainfall events and storms
- Sea level rise
- Increase in population density near water
- Map updates and levee de-accreditations

Where are the gaps and problems?

- Continued Affordability of flood insurance
- Maps provide unintended message of little/no risk beyond 100-year floodplain
- Lack of recognition of residual risk areas behind levees and below dams—those areas must be mapped, regulated and require flood insurance
- Inadequate development standards—e.g. need freeboard, zero rise floodways, no habitable uses in floodway, "no build zones in coastal highest hazard areas
- Maps of flood hazard areas must be based on future development, not yesterday's
- The CRS standards are too low, make most of them NFIP base standards and create some really effective CRS standards that are effective and incentivize local/state actions

What role has subsidies or discounts played in supporting unwise development?

- Are rate subsidies and grandfathering contributing to NFIP insolvency?
- Should the rationale for subsidies be re-examined?
    - If premiums are subsidized, it is no longer a true insurance program
- Should subsidies exist? If for low income folks, what program should pay them?
    - Any low income subsidies should be taxpayer funded and done by HUD
- Rating practices be re-examined for more accurate picture of risk
- How can the NFIP move all policies to actuarial based pricing and avoid policy loss?

If the NFIP is to be a significant tool in the integrated flood risk management perspective, how should it be altered to better support this objective?

- Integrate the NFIP with other federal flood risk programs, including the disaster relief program, Corps of Engineers, EPA and NRCS programs
- FEMA needs to identify cross program policy conflicts that increase risk

- The NFIP must build State FPM capability and capacity or it will not succeed
- The NFIP program should be delegated to states, similar to EPA and DOT programs
- What incentives and disincentives would make it more effective?
- Are the NFIP mitigation grant programs effectively addressing the high risk structures?

How can the NFIP better deliver the risk message and protect the general taxpayer?
- More areas of mandatory coverage--e.g. residual risk areas on rivers and coasts
- More defined set of rates and maps to clarify variation of risk beyond SFHAs
- Modification of 100-year standard for critical facilities & areas of dense population
- Change name and attributes of map so its viewed as risk map, not an insurance map
- Add zones within SFHA so those more at risk pay higher rates than lesser risk structure
- Do not add wind coverage to the flood insurance program

What are some "new ideas" for refreshing and re-invigorating the program?
- Group policies for areas behind levees to be purchased by levee districts
- Flood insurance vouchers for lower income households to be administered by HUD
- Long-term flood insurance to be attached to property, not owner (see Kunreuther)
- Consider requiring flood insurance as a part of all homeowners policies
- Tie Disaster dollars to NFIP compliance, with a sliding scale to reflect how well the community and state are managing their flood risk
- Consider a major change where FEMA would no longer be in charge of flood insurance---turn flood insurance over entirely to the private sector. (this will need to be done carefully so as not to lose the floodplain mgt in communities and states)

TESTIMONY OF JOHN W. ROLLINS, FCAS, MAAA

PRESIDENT, ROLLINS ANALYTICS, INC.

"THE NATIONAL FLOOD INSURANCE REFORM AND MODERNIZATION ACT OF 2010" and

H.R. 1264, "THE MULTIPLE PERIL INSURANCE ACT OF 2009"

FINANCIAL SERVICES – SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

U. S. HOUSE OF REPRESENTATIVES, APRIL 21, 2010

Good afternoon, Ms. Chair and Members. My name is John Rollins. I am an actuary holding the highest qualifications in the Casualty Actuarial Society and American Academy of Actuaries. I have worked in Florida property insurance for the last eleven years and served as chief actuary of both private insurance companies and the state-run "wind pool" of Citizens Property Insurance Corporation. I have testified to lawmakers in several states on the issue of government-backed property insurance systems in disaster-prone areas, and published several research papers on the subject.

After many years of observing public policy decisions and their impact on property insurance markets and public finances, my message to you today is this: In designing rates for any property insurance program ultimately supported by taxpayer capital, great care should be taken that the legislative definition of the phrase "actuarially sound" conforms to the principles of the U.S. casualty actuarial profession.

Some background is in order. We know that an insurance policy is just a promise to pay for a pre-defined type of possible future loss in exchange for an up-front premium. By law, insurance contracts must be backed by capital sufficient to pay claims, even if many claims occur at once and costs are well in excess of the premiums charged. Disasters by definition are infrequent, unpredictable, and severe; for these events, required monies may be twenty or more times the average annual loss contemplated in the premium. The job of actuaries is to determine a fair premium. This job becomes difficult when the losses are catastrophic, and yet more difficult when the supporting capital is provided in other than an arms-length economic transaction – such as via government support.

The relevant Casualty Actuarial Society principle states: *"A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer"*. Each word or phrase in this statement has implications for pricing decisions for government-backed insurance programs.

- First, the phrase "not excessive, inadequate, or unfairly discriminatory" is the core definition of a lawful rate in most states. Therefore, actuarial soundness is historically a sufficient condition for a lawful rate; alternatively, rates cannot generally be actuarially sound yet unlawful.
- Second, such rates must reflect expected costs. It is not sound to peg the rate to the most favorable, most unfavorable, or other convenient outcome – rates must reflect the probability-weighted average over the range of tenable outcomes. In catastrophe ratemaking, this means scientific models simulating thousands of years of activity are useful, since any recent snapshot of activity may show very low or high losses.
- Third, such rates must reflect all costs, not just those we prefer or those we can easily quantify. Rates are to be made on a cost basis rather than an economic or "what the market will bear" basis, but real costs incurred to issue a properly capitalized policy must all be reflected.

- Fourth, such rates must reflect future costs; rates may not be made to recoup past losses. Past data may or may not be predictive of future losses, but past experience does not represent an "account" to be squared by raising or lowering future premiums.
- Finally, and critically, actuarially sound rates must reflect the costs of risk transfer. Rates must include a provision for the cost of capital required on demand to pay claims after catastrophic events. Private insurers transfer risk through reinsurance and risk-sharing arrangements, paying those costs immediately. Government programs can borrow from future taxpayers to fund today's risks; the cost of that capital may be arguable, but actuaries and economists widely agree it cannot be zero. Therefore, an actuarially sound rate for a government-backed insurance program must be greater than simply the expected annual loss to the program plus provisions for known expenses.

The record shows that failure to implement actuarially sound rates in such programs at both the state and federal levels has had unwelcome consequences, including

- Overdevelopment of environmentally sensitive areas, as low insurance rates offered by government –backed insurers and subsidized by future taxpayers encourage consumers and developers to underestimate the risk and build in harm's way;
- Expansion of the risk in government-backed insurance pools as private insurers retreat from risky areas in which they cannot or will not compete with subsidized rates, and crowding out of private investor capital which otherwise would be at risk in lieu of taxpayer capital;
- Depletion of the public treasury as new debt must be incurred under stressed market conditions just after major disasters, then serviced by potentially generations of taxpayers;
- Wealth transfers from all taxpayers to an often high-income subset of residents living in risky but picturesque areas, as all taxpayers pay proportionately to service debt incurred due to underfunded programs.

Despite the fact that enabling legislation frequently utilizes the phrases "actuarially indicated" or "actuarially sound", rates for many existing programs, such as state wind pools and the National Flood Insurance Program, do not reflect a proper cost of capital provision as envisioned in actuarial principles. I believe the lack of a comprehensive and consistent definition of the phrase, and conformity to this definition when the rates are actually set, is partially to blame. I urge lawmakers to carefully define the concept of actuarially sound rates at every stage of legislation, development, and continuing implementation of government-supported property insurance programs.

Thank you for the opportunity to appear before you today.

Testimony of

Barry Rutenberg

On Behalf Of the

National Association of Home Builders

Before the

Unites States House of Representatives

House Financial Services Subcommittee on Housing and Community Opportunity

Hearing on

Legislative Proposals to Reform the National Flood Insurance Program

April 21, 2010

Introduction:

Chairwoman Waters, Ranking Member Capito and members of the Subcommittee on Housing and Community Opportunity, I am pleased to appear before you today on behalf of the 175,000 members of the National Association of Home Builders (NAHB) to share our views concerning efforts to reform the National Flood Insurance Program (NFIP). We appreciate the invitation to appear before the Subcommittee on this important issue. My name is Barry Rutenberg and I am the 2010 Second Vice Chairman of the Board and a home builder from Gainesville, Florida.

NAHB commends the subcommittee for addressing reform of the NFIP program and releasing a draft flood insurance bill that includes a much-needed long-term extension and reauthorization. For the last several years, the NFIP has had to undergo a series of short-term extensions that have created a high level of uncertainty in the program. The NFIP recently experienced several short-term authorization lapses causing severe problems for our nation's already troubled housing markets. Unfortunately, during this latest delay, many homebuyers faced delayed or cancelled closings due to the inability to obtain NFIP insurance for a mortgage. In other instances, builders themselves were forced to stop or delay construction on a new home due to the lack of flood insurance approval, adding unneeded delay and job loss. Moreover, with buyers seeking to qualify for the federal home-loan tax credit before it expires on April 30, the expiration of the NFIP could have significantly impacted the economic benefits of the tax credit as buyers attempted to secure mortgages prior to the deadline. NAHB supports this long-term extension to ensure the nation's real estate markets operate smoothly and without delay and commends the subcommittee for taking action quickly.

Background:

The Federal Emergency Management Agency's (FEMA) National Flood Insurance Program (NFIP) plays a critical role in directing the use of flood-prone areas and managing the risk of flooding for residential properties. The availability and the affordability of flood insurance gives local governments the ability to plan and zone its entire community including floodplains. In addition, if a local government deems an area fit for residential building, flood insurance allows homebuyers and homeowners the opportunity to live in a home of their choice in a location of their choice, even when the home lies in or near a floodplain. The home building industry depends upon the NFIP to be annually predictable, universally available, and fiscally viable. A strong, viable national flood insurance program enables the members of the housing industry to continue to provide safe, decent, and affordable housing to consumers.

The NFIP provides flood insurance to over 5 million policyholders, enabling them to protect their properties and investments against flood losses. Further, the NFIP creates a strong partnership with state and local governments by requiring them to enact and enforce floodplain management measures, including building requirements that are designed to ensure occupant safety and reduce future flood damage. This partnership, which depends upon the availability of comprehensive, up-to-date flood maps and a financially-stable federal component, allows local communities to direct development where it best suits the needs of their constituents and consumers. This arrangement has, in large part, worked well. Unfortunately, the losses suffered in the 2004 and 2005 hurricane seasons, including the devastation brought about by Hurricanes Katrina, Rita and Wilma, have severely taxed and threatened the solvency of the NFIP.

According to FEMA, between the NFIP's inception in 1968 through 2004, a total of $15 billion has been needed to cover more than 1.3 million losses. The 2004 hurricane season required close to $2 billion dollars in NFIP coverage, and the 2005 hurricane season resulted in payments totaling over $13.5 billion. Combined claims for these two years exceeded the total amount paid during the entire 37-year existence of the NFIP program. While these losses are severe, they are clearly unprecedented in the history of this important program and, in our opinion, not a reflection of a fundamentally broken program. Nevertheless, NAHB recognizes the need to ensure the long-term financial stability of the NFIP and looks forward to working with this committee to implement needed reforms.

While NAHB supports reform of the NFIP to ensure its financial stability, it is absolutely critical that Congress approach this legislation with care. The NFIP is not simply about flood insurance premiums and payouts. Rather, it is a comprehensive program that guides future development and mitigates against future loss. While a financially-stable NFIP is in all of our interests, the steps that Congress takes to ensure financial stability have the potential to greatly impact housing affordability and the ability of local communities to exercise control over their growth and development options.

NAHB Supports Thoughtful NFIP Reforms:

The unprecedented losses suffered in 2004 and 2005, including the devastation brought about by Hurricanes Katrina, Rita and Wilma, have severely taxed and threatened the solvency of the NFIP. While these events have been tragic, sobering, and have exposed shortcomings in the NFIP, any resulting reforms must not be an overreaction to unusual circumstances. Instead, reform should take the form of thoughtful, deliberative, and reasoned solutions. A key step in this process is to take stock of where we are today, what has worked, and what has not.

An important part of the reform process is determining what area or areas of the NFIP are in actual need of reform. In the past, a key tool in the NFIP's implementation, the Flood Insurance Rate maps (FIRMs), have been recognized by Congress to be inaccurate and out-of-date. Through the strong leadership of this Committee, FEMA is completing its map modernization effort aimed at digitizing, updating, and modernizing the nation's aging flood maps. While FEMA was successful in digitizing most of the FIRMs, not all have updated hydrologic data and a recent National Academy of Sciences report faulted some of the maps because of a lack of reliable topographical data. The result of this effort is large discrepancies between what was mapped as the 1% annual chance of flood decades ago and what the 1% annual chance of flood is today. Clearly, this and future data will help to ensure better and more-informed decision-making.

Nevertheless, re-engineered FIRMs have both removed and introduced homeowners to the realities of flood insurance. For homeowners who are required to purchase flood insurance for the first time due to a FIRM update, this new and oftentimes unexpected requirement can be confusing and pose unanticipated financial hardship. For this reason, NAHB appreciates the committee's inclusion of language that delays the effective date of the FIRM and phases-in the insurance rates over a 5-year period.

In an attempt to improve both the solvency of the program and its attractiveness to potential policy-holders, NAHB supports a number of reforms designed to allow FEMA and the NFIP to better adapt to changes to risk, inflation, and the marketplace. Increasing coverage limits to better reflect today's home values would provide more assurances that losses will be covered and benefit program solvency by generating increased premiums. NAHB is pleased that the subcommittee's draft legislation includes this much-needed increase. Similarly, creation of a more expansive "deluxe" flood insurance option, or a menu of insurance options from which policy-holders could pick and choose, could provide additional homeowner benefits while aiding program solvency. Finally, increasing the minimum deductible for paid claims would provide a strong incentive for homeowners to mitigate and protect their homes, thereby reducing potential future losses to the NFIP.

NAHB believes that modifying the numbers, location, or types of structures required to be covered by flood insurance may play an important part in ensuring the NFIP's continued financial stability. Two options that have been widely considered in recent years include mandatory flood insurance purchase for structures located behind flood control structures, such as levees or dams, and all structures in a floodplain, regardless of whether or not they currently hold a mortgage serviced by a federally-licensed or insured carrier. Both of these strategies would increase the number of residences participating in the NFIP, buttressing the program against greater losses. While this seems simple in reality, it is much more complicated.

The NFIP and its implementing provisions were not created solely to alleviate risk and generate premiums -- they were created to balance the needs of growing communities with the need for reasonable protection of life and property. Accordingly, NAHB believes that before any reforms are enacted to change the numbers, location, or types of structures required to be covered by flood insurance, FEMA should first demonstrate that the resulting impacts on property owners, local communities, and local land use are more than offset by the increased premiums generated and the hazard mitigation steps taken. Only after such documentation is provided, documentation that includes the regulatory, financial, and economic impact of reform efforts, can Congress, FEMA, stakeholders, and the general public fully understand whether or not such actions are appropriate. NAHB is pleased that the subcommittee's draft flood insurance legislation requires that FEMA conduct a study of the feasibility and implications of such a change in the NFIP's mandatory purchase requirements.

Section 21 of the subcommittee's draft bill requires a report on the inclusion of building codes in floodplain management criteria. NAHB supports efforts to allow the director of FEMA to conduct a study on the efficacy, economic and regulatory impacts, and effectiveness of including widely used and nationally recognized building codes. NAHB believes it would be beneficial to evaluate the effectiveness of allowing states to use the national model codes (e.g., those promulgated by the International Code Council) with state-specific amendments, as currently allowed. The draft language, however, would allow state-prescribed or other privately-developed building codes and standards to be included in the study. Over the last five years, state and local governments have begun adopting various "green" codes and protocols for use as mandatory building standards within their respective jurisdictions. In some cases, these codes may not adequately consider the unique geographic needs for building in zones with the potential for high-impact natural disaster risks. Often, these codes and standards exist outside of the scope of the national model code development bodies and, in addition to being expensive, they do not always provide all stakeholders in the building industry an opportunity to equally participate in their development.

NAHB supports allowing FEMA to investigate the costs and benefits of using the national model codes with respect to flood plain management and enforcement in areas with high-impact weather risks. As such, NAHB recommends that the study language be modified to focus only on the national model codes. At the same time, NAHB believes in the importance of maintaining the flexibility for these areas to adopt innovative ways to address building needs that cannot be achieved through a nationally-applied or privately-developed code.

Finally, hurricanes Katrina, Rita and Wilma radically disrupted the lives of those living on the Gulf Coast. After the storms' passing, many homeowners found themselves in dispute with their property insurance companies over whether water or wind was the primary cause of damage to their homes. After much debate, one proposed solution which has emerged to address this conflict is to expand the authority of the NFIP to include wind coverage. NAHB is therefore pleased to support H.R. 1264, the Multiple Peril Insurance Act of 2009, authored by Representative Gene Taylor (D-MS), that would provide wind insurance for home owners, providing a needed addition to the availability and affordability of property insurance in high hazard areas. NAHB is pleased that H.R. 1264 references the mitigation requirements of consensus-based building codes as a measure to lessen the potential damage caused by a natural disaster and thus further ensure the financial stability of the NFIP. As this legislation moves forward, NAHB urges Congress to limit the amount of the program's fiscal exposure to ensure it financial stability and to require premiums for the new multi-peril coverage to be risk-based and actuarially sound.

NAHB is Concerned with Potential Negative Reforms:

As Congress considers strategies to bolster the financial stability of the NFIP, NAHB cautions against those reforms that have far-reaching and unintended consequences, including reforms that decrease housing affordability and the ability of communities to meet current and future growth needs. Chief among these concerns are changes that would expand the Special Flood Hazard Area (SFHA), fail to take into account flood protection structures when setting premiums, or expand the current federal minimum residential design, construction, and modification standards.

While changes to the NFIP's mandatory flood insurance purchase requirements present one set of issues, a programmatic change of the SFHA presents an entirely different and overwhelming set of concerns. Changing the SFHA from a 100-year standard to a 500-year (or 0.2% annual chance) standard would not only require more homeowners to purchase flood insurance, but would also impose mandatory construction requirements on a completely new set of structures. Furthermore, those homeowners who had been in compliance with the 100- year standards will suddenly find themselves below the design flood elevation for the 500- year flood. Although these structures may be grandfathered and avoid higher premiums as a result of their non-compliant status, this ends when the structure is sold or substantially improved. Placing these homes in this category impacts their resale value in a very real way, as any new buyer may be faced with substantially higher premiums or retrofit and compliance costs.

The revision of the SHFA standard not only affects homeowners, but also homebuilders, local communities, and FEMA. An expanded floodplain means an expanded number of activities taking place in the floodplain, and a corresponding increase in the overhead needed to manage and coordinate these activities. A larger floodplain would likely result in an increased number of flood map amendments and revisions, placing additional burdens on federal resources to make these revisions and amendments in a timely fashion. Residents located in a newly-designated SFHA would need to be notified through systematic outreach efforts. Communities would likely need to modify their floodplain ordinances and policies to reflect the new SFHA. In short, the entire infrastructure of flood management and mitigation practice and procedures institutionalized around the 1% standard would need to change.

Although a revision of the 1% SFHA standard has been considered in recent years, even specially-convened policy forums have failed to reach consensus on the issue. What has started to emerge, however, is a recognition of the tremendous implications that changing the SFHA would have on homebuilders, homebuyers, communities, and the federal government itself. NAHB strongly cautions against making such sweeping changes to the NFIP without first having all the facts in-hand. Only after Congress and FEMA have adequately documented that a drastic revision of the SFHA is absolutely necessary to the continued existence and operation of the NFIP, should a programmatic revision of the SFHA be considered.

Another important component of the NFIP is the ability of communities, with the assistance of the federal government, to design, install, and maintain flood protection structures. In most instances, residential structures located behind dams or levees providing protection to the 1% annual chance level are not required to purchase flood insurance. This is because most structures are removed from the 100-year floodplain or SFHA on the relevant FIRM through the Letter of Map Revision, or LOMR, process. Accordingly, any reforms that contemplate bringing these same residences back under a mandatory purchase requirement raise very real and powerful equity and fairness issues. Should Congress or FEMA produce adequate documentation indicating that the benefits of mandating flood insurance purchase for residences behind flood control structures outweigh the costs to homeowners, NAHB would support these residences being charged premiums at a reduced rate to reflect their reduced risk. A great deal of time and taxpayer money were invested to provide additional flood protection to these residences, and it is only fair that homeowners in these areas, if required to purchase insurance, be recognized for their communities' efforts.

While requiring mandatory flood insurance purchase is one option, another option may be to require that structures meet federal residential design, construction and modification requirements. NAHB is strongly opposed to expanding such requirements to new classes of structures, including those found behind flood protection structures and those affected by any programmatic change to the SFHA. These requirements would substantially increase the cost of new home construction and severely impact housing affordability. For example, on the Gulf Coast, elevating new structures could add $30,000 to the cost of the homes, depending on the estimate source and size of the home. NAHB has conducted research that shows that a $5,000 increase in housing price in New Orleans would eliminate 6,089 households from the housing market. It is easy to see the tremendous impact that such reforms would have not only on nation's home builders, but on the nation's home buyers. NAHB urges Congress to soften the impact of any programmatic changes to the NFIP by ensuring that construction requirements remain tied to the 1% standard.

Finally, the subcommittee's draft bill would phase-in actuarial rates for non-residential properties and non-primary residences. NAHB's primary concern is that flood insurance remains available and affordable. FEMA reports that 76% of policy-holders are already paying actuarial (risk-based) premiums; nevertheless, NAHB believes reforms aimed at reducing federal subsidies for any subset of the remaining properties must ensure that overall affordability in not adversely affected. NAHB looks forward to working with the committee to strike the proper balance between ensuring the long-term financial viability of the NFIP, and ensuring program affordability and equality for those who rely on this valuable government insurance program.

Thank you for this opportunity to share the views of the National Association of Home Builders on this important issue. We look forward to working with you and your colleagues as you contemplate changes to the National Flood Insurance Program to ensure that federally-backed flood insurance remains available, affordable, and financially stable. We urge you to fully consider NAHB's positions on this issue and how this program enables the home building industry to deliver safe, decent, affordable housing to consumers. I look forward to any questions you or other members of the committee may have for me.

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HEARING BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ENTITLED

"LEGISLATIVE PROPOSALS TO REFORM

THE NATIONAL FLOOD INSURANCE PROGRAM"

WRITTEN TESTIMONY OF

MOE VEISSI, 2010 FIRST VICE PRESIDENT

NATIONAL ASSOCIATION OF REALTORS®

APRIL 21, 2010

Introduction

Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee, on behalf of more than 1.2 million REALTORS® who are engaged in all aspects of the residential and commercial real estate industry, thank you for inviting me to testify today regarding legislation to reform the National Flood Insurance Program (NFIP).

My name is Moe Veissi. A REALTOR® for 40 years, I am broker/owner of Veissi & Associates Inc., in Miami, Florida. I have been active within the National Association of REALTORS® (NAR), holding significant positions at both the state and national levels. Since 2002, I have been the President of the Florida Association, an NAR Regional Vice President, and a member of the NAR Board of Directors. Most recently, I was elected NAR First Vice President for 2010.

On March 28, 2010, statutory authority for the NFIP expired. Unable to reconcile differences between the House and Senate flood insurance reform bills, Congress has adopted seven short-term extensions since September 2008 – all within a few days of the deadline (This includes the current extension to May 31). This month-to-month approach hinders a recovering real estate market and creates uncertainty for the more than five and a half million taxpayers who depend on the NFIP as their main source of protection against flooding, the most common natural disaster in the United States. Without flood insurance, federally-backed mortgages may not be secured for residential or commercial real estate transactions in nearly 20,000 communities across the nation. NAR urges Congress to enact at minimum a five-year extension that strengthens the program's fiscal foundation while also avoiding changes that may result in market inequities and housing affordability problems.

The Importance of the National Flood Insurance Program

Congress established the NFIP in 1968 so that property owners would have access to affordable insurance against losses due to flooding. This program represents a unique partnership among property owners, all levels of government, and the private sector, and participation is voluntary for communities. These communities participate by adopting floodplain management ordinances to reduce future flood damage. In return, the NFIP makes federally-backed flood insurance available to property owners and renters in these communities.

The NFIP has effectively reduced the costs of flood damage not only to property owners but also taxpayers. According to the Federal Emergency Management Agency (FEMA), flood damage is reduced by nearly $1 billion a year as the result of communities implementing floodplain management ordinances and property owners purchasing flood insurance. Buildings constructed to NFIP standards experience 80 percent less damage than those not built to standards. By ensuring access to affordable flood insurance, taxpayers pay less for post-disaster relief to flood victims. As a program evaluation finds, the program "has clearly induced savings on flood costs" and that "flood insurance has shifted the loss from taxpayers to those who pay the insurance premium."[1] While the NFIP has been effective at reducing societal costs, flood damage since 2005 has highlighted the need for reforming the program to better protect more people at risk and put the program on a stronger financial footing.

As of January 2009, the NFIP owes $19.2 billion to the U.S. Treasury. This includes $2.6 billion that FEMA had to borrow to pay claims for Hurricane Ike and the Midwest floods of 2008. Prior to 2005, the NFIP had been largely self-supporting, collecting sufficient premiums and fees to cover expenses and claim payments. In the few years when this was not the case, the program was able to pay back the debt with interest. Today however, the program is no longer in that position according to the Congressional Research Service.[2]

NAR Supports Long-Term Reauthorization and Reform

NAR supports at minimum a five-year NFIP reauthorization to provide certainty to a recovering real estate market as well as to the millions of taxpayers that depend on the program for flood insurance. NAR also supports reforms that strengthen the program's financial footing by increasing participation in (and therefore funding for) the program and setting premiums for repetitive loss properties according to their full risk. Though supportive of NFIP reform, REALTORS® would oppose the phase-in of "full risk" premiums for all pre-FIRM properties.[3] NAR encourages Congress to strike a balance between ensuring the NFIP's long-term fiscal viability while avoiding changes that could result in non-risk based market inequities as well as housing affordability problems, especially for lower-income homeowners and renters.

<u>Repetitive Loss Properties</u>. NAR supports establishing premiums for repetitive loss properties according to the full risk posed by such properties to the NFIP. These are properties that have repeatedly suffered insured flood losses and declined a reasonable offer of mitigation funding from FEMA. Though a small percentage of properties covered by the NFIP, such properties receive a disproportionate share of payouts from the program.

Repetitive loss properties pose a significant financial burden to the NFIP. Research conducted by the Multihazard Mitigation Council of the National Institute of Building Sciences found that a dollar spent on mitigation saves society an average of four dollars.[4] NAR supports amending the flood mitigation assistance program to allow "demolition and rebuilding" as a mitigation measure. In addition, NAR supports funding for mitigation activities for individual repetitive loss properties, and extending the pilot program for mitigation of severe repetitive loss properties.

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[1] Pacific Institute for Research, "Costs and Consequences of Flooding and the Impact of the National Flood Insurance Program" (October 2006), p. 28 (hereafter, "PIR Study").

[2] Congressional Research Service, "National Flood Insurance Program: Background, Challenges, and Financial Status," (July 2009).

[3] By "Pre-FIRM," we are referring to properties built prior to December 31, 1974 or the date of completion of the flood map for the community in which the property is located.

[4] Multihazard Mitigation Council, "Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities, Volume 1 – Findings, Conclusions and Recommendations," National Institute of Building Sciences, Washington, D.C. (2005), p.5.

Increased Participation. Another way to help support the future stability of the NFIP is to encourage participation in the NFIP. Increasing participation would lead to increased funds for the NFIP, help property owners recover from flood losses, and decrease future federal assistance when uninsured properties flood and suffer loss.

Educating consumers would increase participation. Many consumers may not be aware that flood insurance is available to them. Only 50% of homeowners in federally designated flood areas purchase flood insurance.[5] NAR would strongly support provisions for outreach, education and information to consumers about the availability and importance of flood insurance.

Offering additional coverage also would attract new NFIP participants. Increasing the maximum coverage limits for residential properties, non-residential properties, and contents coverage would more accurately reflect increases in property and contents values and provide fuller coverage to policyholders. Coverage limits have not been adjusted despite inflation since 1994. In addition, adding coverage for living expenses, basement improvements, business interruption and replacement cost of contents would help increase protection for home- and small-business owners.

NAR Opposes Phasing-in "Full Risk" Premiums for all pre-FIRM Properties

NAR opposes phasing-in "full risk" premiums for non-residential and non-primary residential properties. Similarly we oppose such a phase-in for residential properties based on the sale price. NAR encourages Congress to strike a balance between ensuring the long-term fiscal viability of the NFIP while avoiding changes that could result in market inequities as well as housing affordability problems, especially for lower-income homeowners and renters.

Commercial Properties. Similar properties facing the same risk of loss should not be charged different rates. Both lack access to affordable property insurance in the private market at a time when commercial real estate is struggling with the greatest liquidity crisis since the Great Depression. Often it is the small commercial property owner that suffers the greatest. These are the owners of America's small businesses that are the engine of job creation and innovation and backbone of their local communities. But due to their single location, these owners are not as able to offset the increases in insurance costs for one property with lower insurance costs in other parts of the country; nor are they able to negotiate a lower multiple property rate as larger owners might be able to do. For small businesses that own their properties, there is a point at which insurance becomes unaffordable, i.e. when insurance expenses are so high that property no longer generates sufficient income to cover expenses. This problem can force owners to sell their properties. It can also lead to mortgage default and even foreclosure, especially during an uncertain economy when there are little-to-no buyers.

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[5] PIR Study, p. 36.

Residential Properties. NAR also opposes phasing-in "full risk" premiums for pre-FIRM primary or non-primary residences, including those proposals that would focus on properties based on the home's occupancy and/or sales price. Once again, Realtors® believe that properties facing the same risk of loss should not be charged different rates. While we would support increasing rates on properties with repetitive losses and thus a disproportionate share of NFIP payouts, increasing the rate on only some property owners directly or indirectly due to their income or assets would be unprecedented for the NFIP.

Properties receiving "subsidized" or less-than actuarial rates were built prior to December 31, 1974 or the date of completion of the flood map for the community in which the property is located, whichever date is later. It should be noted that the use of this term "subsidized" is misleading; Congress authorized a discount for such "pre-FIRM" structures because they were built prior to adoption of the flood maps and without the knowledge of the flooding risks inherent in the sites. Changing the rules in the middle of the game could have been perceived as unfair or even punitive. It was assumed at that time that eventually these older buildings would be replaced by newer flood resistant construction; in practice, this process has taken longer than assumed.

As noted above, NAR would support removing the discount on properties with repeated flood losses, which receive disproportionate payouts from the program. In these cases, the property owner has been notified but declined a reasonable offer of mitigation funding from FEMA. This would not be changing the rules in the middle of the game. However, when the discount is removed either directly or indirectly based on measures such as type of occupancy or the income or assets of its owner, discounts would no longer be based on risk of payout, and NAR would be forced to oppose such a provision.

Eliminating risk-based discounts would increase the cost of home ownership and rents in older communities as well as those that rely on tourism. This could help to contribute to additional rounds of delinquencies, foreclosures and reduced property tax bases in these communities. FEMA estimates that if the average discounted policy were to pay its full premium, that premium would be increased to about two and a half times the current level; some properties could see premiums increase four-fold or more. Again, there is a limit to the amount that insurance, or any other expense, can increase before owners are either forced to sell their properties, or go without insurance.

NAR is also concerned that this type of approach would also apply to multi-family and single-family residential rental properties, and more importantly, the families that rent these properties. For a renter, the apartment or house in which he or she is living is a primary residence, but could be considered either a commercial property or a non-primary residence because it is non-owner-occupied. Thus, if the discount were eliminated and owners were unable to cover the additional annual flood insurance costs, tenants would face rent increases that would have a dramatic effect on rental housing affordability, especially in the case of low and fixed-income individuals and families.

The Congressional Budget Office (CBO) has found no evidence to suggest that the risk-based discount would cover larger or more luxurious structures, whether inland or in a coastal area.[6] Another study on the NFIP found that those in the middle-income brackets were less likely to live in federally designated flood areas than either of those in the highest or lowest income brackets. That study noted that "low income households [defined as $10,000 - $30,000 per year] live in hazardous areas in order to find affordable housing or because they work in water recreation areas and find the least expensive housing nearby."[7]

NAR would also contend that by maintaining a risk-based discount, Congress would not encourage development of "environmentally sensitive" areas. A report released in October 2006 that found "[t]he common belief that the NFIP has stimulated development that increased flood losses is not supported by our findings."[8]

H.R. 1264, the Multiple Peril Insurance Act

Another focus of this hearing is H.R. 1264, "the Multiple Peril Insurance Act" which has been introduced by Rep. Gene Taylor (D-MS). After Hurricane Katrina, property owners with an insurance policy expected to be reimbursed for the full damage suffered. However, insurers declined to cover wind damage under the homeowner's policy if some of the damage was deemed due to flooding, and the NFIP supplement to the policy would only cover flood-related damage. In effect, property owners who had been paying for years for this insurance were caught in the middle of a legal dispute between insurers and the NFIP.

The Multiple Peril Insurance Act would allow homeowners to buy comprehensive insurance and know that hurricane damage would be covered without lengthy legal disputes over how much damage was caused by wind and how much was caused by flooding. Premiums for the wind coverage would be risk-based and actuarially sound. Coverage would be limited. The CBO has scored the bill as budget neutral.

The bill would also reduce future property damage by requiring participating communities to adopt International Building Codes. Windstorm insurance would be available only where the local governments adopt and enforce the International Building Code or equivalent building standards. Thus the bill would not only prevent insurers from shifting liability back to the federal government, it would also save taxpayers money by increasing the number of properties that are mitigated against future wind damage and paid for by insurance premiums rather than post-disaster federal assistance.

The Need for a Comprehensive Natural Disaster Policy

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[6] CBO, "Value of Properties in the National Flood Insurance Program," (June 2007), p. 7.

[7] PIR Study, p. 43.

[8] Ibid, p. 41.

In addition to reforming the NFIP, NAR urges Congress to enact a comprehensive, forward-looking natural disaster policy that encourages personal responsibility, promotes mitigation, ensures insurance availability and affordability, and strengthens critical infrastructure.

Without federal government involvement, the private market will not provide access to affordable insurance for a range of natural catastrophe risks, including wind damage. Home- and business owners demand insurance to protect themselves, their families and their property from catastrophe. However, if insurance is not available or affordable, many make the unfortunate, but rational, economic decision to purchase only minimal insurance. If "the big one" hits, and people cannot afford insurance, everyone will pay through taxpayer-funded disaster assistance.

Today, U.S. policy toward natural catastrophe risk is largely reactive rather than proactive, case-by-case rather than comprehensive, and that has to change. The default approach of the federal government has been to wait and respond: wait for the next disaster and then respond by providing financial assistance to the victims. For example, after Hurricanes Katrina, Rita and Wilma struck the southeastern coastline, the federal government paid for much of the cleanup – all with taxpayer dollars. Of the $88 billion obligated to the Gulf Coast states, $26 billion went directly to under-insured property owners according to the General Accountability Office.[9] That is $26 billion that would not have been necessary or paid by taxpayers, including those not living near the U.S. coast, had a proactive federal policy been in place, to make property insurance more widely available and affordable.

As the PIR study referenced earlier shows, proactively addressing disaster risks benefits all. The decidedly proactive approach taken to flooding risks via the NFIP has reduced the costs of damage not only to property owners but also to taxpayers. The program has reduced the cost because participating communities must adopt floodplain management ordinances and building standards that mitigate against future flood losses. By ensuring access to flood insurance, that reduces the amount of post-disaster federal assistance for which taxpayers have to pay. Proactively addressing the risks that other natural hazards create would save taxpayers additional money.

Having a more comprehensive natural disaster policy is essential in the coming years since there is no guarantee that 2010 or any future years will be as benign for natural catastrophes as 2009. Another Katrina-size disaster or Northridge earthquake are not a question of if, but when. As we have learned, it is far less costly to prepare ahead of time than to fund recovery efforts.

Conclusion

Thank you again for the opportunity to share the Realtor® community's views on needed changes to the NFIP. NAR stands ready to work with members of the Committee to develop meaningful reforms to the

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[9] General Accountability Office, "Natural Disasters: Public Policy Options for Changing the Federal Role in Natural Catastrophe Insurance," (November 2007), Figure 3.

NFIP that will help protect property owners and renters prepare for and recover from future losses resulting from floods.