

Testimony of
David I. Maurstad
Director and Federal Insurance Administrator
Mitigation Division
Federal Emergency Management Agency
Department of Homeland Security
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Good afternoon Chairman Watt, Ranking Member Miller, and Members of the Subcommittee. I am David Maurstad, Mitigation Division Director and Federal Insurance Administrator for the Federal Emergency Management Agency (FEMA) within the Department of Homeland Security. I appreciate the opportunity to appear today before the Committee to discuss the status of the National Flood Insurance Program (NFIP).

This afternoon I would like to provide a context for how the NFIP has moved forward since Hurricanes Katrina, Rita and Wilma made landfall in 2005. As you know, the NFIP was established in 1968 to make affordable flood insurance available in communities that would adopt and enforce measures to make future construction safer from flooding. From 1968 through 2004, a total of \$15 billion had been paid out to cover more than 1.3 million claims.

After the June 2004 signing of the Flood Insurance Reform Act (FIRA04), the United States experienced back-to-back catastrophic hurricane seasons. The 2004 hurricane season resulted in over 75,000 claims totaling a record payment of over \$2 billion dollars. That record fell in 2005 when Hurricane Katrina resulted in claims to date totaling over \$16.3 billion – over eight times that of 2004 and surpassing, by over a billion dollars, the total amount the NFIP had paid out since the Program began.

Last year I informed the House Financial Services Committee and the Senate Banking Committee that we expected the total NFIP payout (claims and associated expenses) for the 2005 hurricane events to be over \$23 billion. We have reexamined that projection based on actual claims and payments to date, and lowered the estimate for claims payments, related adjustment expenses, and interest paid on borrowing to approximately \$21 billion.

From 1986 until the 2005 hurricane season, the NFIP has been self-supporting. During periods of high losses, consistent with the law, the NFIP has borrowed from the U.S. Treasury. The authority to borrow from the Treasury is an essential part of the NFIP's financing design by providing the necessary resources in those years where claims exceed average annual historic loss levels. This authority enables the program to borrow limited amounts from the Treasury on occasions when income is not sufficient to cover claim payments and related costs. The loans from this period have been repaid, with interest, from policyholder premiums and related fees.

The large number of claims and severity of flood losses from the 2004 and 2005 hurricane seasons are unprecedented in the history of the NFIP. The challenges these storms have presented to the Mitigation Division, particularly the 2005 hurricane season, – in terms of flood insurance claims handling, floodplain management, flood hazard mapping and mitigation planning and grants management – have never been encountered, on this scale, before.

Program claims have been resolved expeditiously. Only five months after Hurricanes Katrina, Rita, and Wilma struck the Gulf Coast, the NFIP had resolved over 70 percent of the 241,000 claims filed from these events. By the summer of 2006, we had resolved nearly all of our 2005 hurricane season flood claims – a volume that far exceeded the highest number of claims filed from any single event in the NFIP’s history, and more than triple the total number of claims filed in 2004. Our industry partners – our Write-Your-Own (WYO) insurance companies, as well as claims adjusters and agents – have more than fulfilled their responsibility to help NFIP policyholders begin to rebuild their lives.

In the wake of the worst natural disaster the Nation has ever experienced, we have continued to fulfill the promises made to NFIP policyholders and communities. FEMA is proud of the NFIP’s ability to provide solid customer service to our flood insurance policyholders.

This testimony will address the NFIP’s financial status as well as the following matters: (a) the new materials and innovative approaches the NFIP has used to find, help, and inform Gulf Coast policyholders; (b) how the NFIP expedited adjustment and claims processes after Katrina, and the quality control inherent in such efforts; (c) the NFIP technical information available to Gulf Coast communities to help them rebuild wisely; (d) the opportunities the NFIP is pursuing to fundamentally strengthen the Program’s financial underpinnings; and (e) six issues/questions articulated in the February 20, 2007, letter from the Honorable Melvin L. Watt, Chairman of the House Subcommittee on Oversight and Investigations, inviting FEMA to testify at this hearing.

NFIP Financial Status

The extremely active 2004 and 2005 hurricane seasons raised the Nation’s awareness of the flood risks we all face; consequently, the NFIP’s policy base has grown dramatically. The NFIP has over 5.4 million policies for homes, businesses, and other non-residential property owners insuring in excess of \$1 *trillion* in assets. The NFIP now collects more than \$2 billion annually in premiums and fees. As previously stated, from 1968 (the NFIP’s inception) through 2004, the Program paid out \$15 billion to cover more than 1.3 million claims. Many of these claims occurred as a result of smaller flood events that did not rise to the level of a Presidential disaster declaration and for which Federal disaster assistance was not available. Yet many of these property owners endured as much of an individual loss as those in larger events. In this regard, studies have indicated that when insurance premiums fully reflect underlying risks, insurance is the most efficient and equitable method of providing disaster assistance.

It also is important to note that NFIP rate schemes are not designed to cover catastrophic events or years. Congress intended the National Flood Insurance Program to cover claims for the “average historic loss year,” plus expenses associated with administering the Program. A vast majority of the NFIP’s 2005 claims, for instance, resulted from the largest levee failure in the Nation’s history, an event not envisioned during the NFIP’s inception, but one that must be considered as we work to strengthen this important Program.

The NFIP provides insurance at actuarial (risk-based) rates for newer construction, with most policyholders paying full actuarial rates. Structures built prior to the mapping and implementation of NFIP floodplain management requirements are considered pre-Flood Insurance Rate Map (FIRM) buildings. The NFIP charges the owners of these pre-FIRM structures – which make up 24 percent of all NFIP policies – heavily discounted rates on the first \$35,000 of their structure’s insured value, and full risk-based rates for the remaining insured value because adequate flood risk information did not exist when the structures were built. Those with NFIP policies covering pre-FIRM structures are paying, on average, only 40 percent

of a full risk-based premium, with the NFIP considering the remaining 60 percent as forgone revenue – a loss that is *not* passed on to other NFIP policyholders.

As mentioned earlier, we now anticipate that total borrowing for the 2005 hurricanes will exceed \$20 billion. Annual interest on such borrowing will be approximately \$800 million. The 2005 flooding events were of a magnitude far beyond the ability of policyholder premiums to cover. Since Hurricane Katrina struck the Gulf Coast in August 2005, Congress has increased the NFIP's borrowing authority three times to the present limit of \$ 20.775 billion. This additional borrowing authority has been a critical element of the NFIP's ability to effectively serve our policyholders, allowing FEMA to resolve almost all of the Katrina, Rita, and Wilma claims received to date. However, under current loan obligation arrangements – with the NFIP needing new loans at least every six months to cover semi annual interest payments – it is unlikely that the Program will ever be able to retire its debt.

Innovative Materials and Approaches to Help Gulf Coast Policyholders

In the aftermath of Katrina, the 2004 Flood Insurance Reform Act was instrumental in our ability to effectively inform and help Gulf Coast policyholders, and continues to be a catalyst for programmatic success and improvement. We began implementing Reform Act changes during the 2004 hurricane season, and we improved our delivery during the 2005 hurricane season by distributing informative materials, designing innovative post-disaster systems, and implementing important training initiatives.

New Materials

Increasing risk awareness among homeowners and consumers with improved, succinct information is one of the NFIP's basic principles, and is an important element of the 2004 Flood Insurance Reform Act. FEMA, through an aggressive education and outreach campaign, is continuously designing and upgrading informational material to increase the public's awareness of flood risks and to effectively keep our policyholders informed.

For instance, immediately following Hurricane Katrina, we distributed two documents to policyholders to help them through the claims process: The *NFIP Summary of Coverage* and the *Flood Insurance Claims Handbook*. These easy-to-understand materials, developed in concert with our insurance industry partners, are being distributed to all policyholders at the time of initial purchase, policy renewal, and at the time a claim is filed. In addition, FEMA and the WYOs distributed these materials in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers – as well as in Town Meetings – soon after Katrina made landfall. I personally handed these materials to State Insurance Commissioners in Alabama, Mississippi, and Louisiana. Also, we, along with the WYOs, distributed an informational CD containing these documents and other ready-to-print materials to field offices, State and local government offices, and the media.

Innovative Post-Disaster Systems

Also, recognizing that a significant number of Gulf Coast policyholders were displaced, FEMA implemented several systems to reach policyholders early in the claims process. These systems were particularly useful to those who are cut off from their usual sources of information and communication. For example, in the days immediately following Katrina, we cross-referenced a National Processing Service Center report of all callers who applied for disaster assistance and indicated they had flood insurance. We matched the addresses of damaged properties to NFIP policy addresses and connected insurance companies to their flood insurance policyholders. This helped the WYO Companies to reach out to their NFIP policyholders and help them immediately

when they needed it most. This system will now become standard operating procedure in future flooding events.

Training of Agents Who Sell Flood Insurance

Flood insurance training for insurance agents is a high priority for the NFIP. Reform Act training requirements were published in the September 1, 2005 *Federal Register*, and we continue to work with the States as well as the insurance industry and related associations to inform insurance companies and agents of these requirements. To date, 31 states have implemented training requirements for agents who sell flood insurance. Additionally, FEMA has recently brought new flood insurance training material on-line. Now, insurance agents in 27 States can earn three hours of continuing education credit for successfully completing this new web-based course.

These innovative materials, systems, and training initiatives carry out the provisions and intent of FIRA04, and the desire of the NFIP to reach out – with easy-to-understand information – to policyholders as early in the claims process as possible, recognizing that the sooner claims are settled, the sooner people can start rebuilding their lives and communities.

Expedited Adjustment and Claims Processing After Katrina

Given the unprecedented number of claims, widespread destruction, and the difficulties encountered by adjusters accessing the devastated areas, FEMA is especially appreciative of our insurance industry partners as we developed and implemented streamlined adjustment and claims processes designed to effectively serve policyholders.

After Hurricane Katrina, then Rita, then Wilma, the NFIP's insurance company partners utilized state-of-the-art aerial imagery, up-to-date water-depth data, and detailed information from extensive underwriting files to rapidly identify insured properties that had been washed off their foundations, had standing water in them for an extended period, or had only pilings or concrete slabs remaining. FEMA also waived proof of loss requirements and fast-tracked claims up to the maximum insured value.

These streamlining methods substantially reduced our normal adjustment times from what the NFIP would normally see under such extreme circumstances. Furthermore, these processes provided mechanisms for rapidly resolving claims within 60 days of the event. The NFIP estimates that over 17,200 claims have been handled through our expedited claims process.

It is important to note that the NFIP's streamlined adjustment processes and claims expediting are not performed at the expense of quality control. From the beginning, FEMA general adjusters and claims staff have been in the field re-inspecting sample sets of claims in order to ensure the integrity of the process. This is in addition to our regular adjuster monitoring we perform through operation reviews, biennial audits, audits for cause, audits by the Office of the Inspector General, and Congressional inquiries.

Helping Communities Rebuild Wisely

In addition to ensuring that the NFIP's streamlined adjustment and claims processes are effective, transparent, accurate, and fair, FEMA, the Mitigation Division, and the NFIP are doing all they can to make sure that communities recover and rebuild wisely. As such, FEMA is strongly encouraging Gulf Coast communities to assess and utilize all relevant, current technical resources and information available – including updated flood hazard information – in all planning, mitigation, and rebuilding efforts.

Hurricanes Katrina and Rita had significant impacts on flood hazards in coastal Mississippi and Louisiana. As citizens in these areas continue to recover, updated flood hazard information is being provided to help guide reconstruction. For instance, FEMA has provided Mississippi and Louisiana with Advisory Base Flood Elevations (ABFEs) to help rebuilding efforts in region's most heavily affected counties and parishes. Presently, 14 Mississippi communities have adopted ABFEs or higher regulatory elevations. In Louisiana, 36 communities have adopted ABFEs or higher regulatory elevations.

The release of ABFE guidance is for advisory purposes, and will not increase NFIP flood insurance premiums or requirements. However, when ABFEs are provided to affected communities – and the information will not be developed after every event – FEMA requires those communities to use the guidance for all rebuilding activities that involve FEMA mitigation and public assistance grant programs. There is simply no sense in spending tax dollars to rebuild to outdated standards only to have similar damage when the next storm comes along.

Strengthening the Program

Significant flood events have played a major role in the NFIP's evolution: the Program was created when Hurricane Betsy carved a swath of destruction through the Gulf Coast in 1965; Tropical Storm Agnes in 1972 provided the impetus for the mandatory purchase requirements to increase participation in the program; and the 1993 Midwest Flood was the catalyst behind the National Flood Insurance Reform Act of 1994 and its stronger lender compliance requirements. It is entirely appropriate, therefore, that the catastrophic 2004-2005 hurricane seasons are generating a need to seriously consider how the NFIP can be further adjusted and strengthened.

Over the past year and a half, in testimony before the House Financial Services Committee and Senate Banking Committee, and in presentations at various events nationwide, I have outlined the following mitigation and insurance principles:

- Protect the NFIP's integrity by covering existing commitments and liabilities;
- Phase out discounted premiums in order to charge policyholders fair and actuarially sound premiums;
- Increase NFIP participation incentives and improve enforcement of mandatory participation in the program;
- Increase risk-awareness among homeowners and consumers by improving information quality; and
- Reduce risk through combinations of proven mitigation practices and explore opportunities to reduce risks through enhanced protective measures.

Now is the time to complement our mitigation and insurance principles with several NFIP enhancements. To strengthen the NFIP, and to foster our commitment to reduce the Nation's flood risks, we believe Congress should consider the following NFIP adjustments:

- Provide authority to eliminate premium discounts over time for properties built before flood insurance rate maps were in place, particularly for other than primary residences.

- Strengthen the mandatory insurance purchase requirement for Federally-regulated lending institutions to require insurance to value as opposed to the outstanding balance of the loan, and for the life of the loan, and to require more frequent and thorough portfolio reviews by lending regulators.
- Increase the penalties for Federally-regulated lending institutions that do not comply with their mandatory purchase regulatory responsibilities.
- Study the feasibility and implications of expanding the standard for mandatory purchase requirement to include properties in the 0.2% chance per year floodplain (500-year flood plain) and properties in areas of residual risk – structures protected by levees, dams, and other manmade structures. Levee failure vastly increased the number of NFIP claims in New Orleans, and the proper depiction of areas behind levees on Flood Insurance Rate Maps continues to be one of the NFIP’s primary concerns.
- Provide for additional Increased Cost of Compliance (ICC) coverage – money for NFIP policyholders to bring their structures up to existing flood-related building codes-- that is in addition to available building limits. Remove the \$75 cap on ICC premiums so that a variety of ICC options can be offered to the policyholder.

Finally, I would like to address the six specific questions included in the invitation letter I received for this hearing.

1. “The NFIP’s views about whether all claims by write-your own (WYO) companies in the Gulf Coast area have been properly classified as water damage, in which the NFIP is responsible for paying the claim, rather than wind damage, in which private insurers would be responsible for paying the claim.”

When a policy holder under either the NFIP or a private insurance company files a claim for damages under the respective policies, the insurance company assigns an adjuster to the case who will come out to the property and examine the damages and that information will be used to determine the loss and how much an individual policy holder is entitled to. This determination is based on the available evidence, which in most instances will be the damaged property itself. When a policy holder has both a flood insurance policy and a traditional homeowner’s policy, each of the insurance companies must examine the property to make a determination of liability. The question that you ask only comes into play where the WYO that holds the NFIP policy also holds the traditional homeowner’s policy.

In those limited circumstances where one adjuster was responsible for determining the damage eligible for recovery from both the NFIP and a traditional homeowner’s policy held by the WYO, that those the NFIP has a rigorous program of oversight to ensure proper assignment of liability. Following Katrina, the NFIP ordered random re-inspection of damaged structures by third-party adjusters to affirm proper handling, as well, at the request of either a WYO or the insured, the NFIP conducted special re-inspections to verify proper handling and resolve coverage disputes, including disputes over whether damages were caused by wind or water. The NFIP is also subject to audits by the Inspector General of DHS.

2. “NFIP’s positions on participating in mediation with policyholders and private insurers to settle disputed claims, particularly involving wind versus water disputes.”

Following a disaster, the NFIP prides itself on swiftly and accurately resolving claims by its policy holders. This has resulted in our ability to close over 99 percent of claims without any legal procedure. Further, the 2004 Flood Insurance Reform Act passed by Congress required FEMA to publish an appeals process, which became effective on November 13, 2006. This process will enable NFIP flood insurance policyholders to appeal claim-settlement decisions of adjusters, agents, WYO insurance companies, and FEMA. We believe that this process will only further increase our ability to address the needs of our policy holders amicably, and without legal proceedings.

The NFIP encourages WYO companies to make or continue to make this alternative dispute resolution option available to policyholders. Additionally, I want to stress that mediation outside of the normal WYO claim handling process will provide NFIP policyholders an additional mechanism to resolve their flood claim – but only their flood claim. While such a process could have merit where a WYO also holds the traditional homeowner’s policy, there are important separation of power issues with proposals that allow a State official to exercise authority over the Federal Flood Insurance Program. It is important to point out once more that the NFIP has long operated at a high success rate in resolving claims without litigation – success that can be directly attributed to the solid NFIP-Insurance Industry partnership.

3. “How the NFIP develops requirements for private insurers to enter into WYO arrangements and what mechanisms are available to the NFIP to monitor WYO actions in providing policies to residents.”

Private insurers must meet NFIP requirements in order enter into WYO arrangements. These requirements consider criteria such as: a company’s experience in the Property and Casualty arena; a company’s standing with its State Insurance Department; the capability of a company’s distribution system to adequately sell and service flood insurance policies; and the ability of a company’s resources to meet all NFIP reporting requirements.

Code of Federal Regulations Part 44, Section 62.24 clearly delineates the criteria that companies must meet in order to participate in the WYO program. FEMA believes that these standards are reasonable indicators that a company has the experience and qualifications necessary to write insurance policies under the NFIP. To ensure that a company complies with WYO Arrangement’s provisions, FEMA (a) reviews the monthly statistical and financial submissions called for by the WYO Financial Control Plan; (b) requires companies to arrange for independent biennial audits of its NFIP business; and (c) conducts underwriting and claims operational reviews. Companies with reporting errors over certain thresholds, or with unsatisfactory audit or review findings, are subject to be called before the WYO Standards Committee, composed of Federal and company executives, to outline plans for corrective action.

4. “The process by which adjusters are certified as NFIP adjusters.”

Claims Adjusters must successfully pass an approved claims course every year to maintain their NFIP certification. NFIP Claims Workshops are held Nationwide from January through May to avoid interference with hurricane season, which begins in June, and is historically the NFIP’s busiest time of year.

The NFIP Bureau & Statistical Agent will issue certified NFIP Claims Adjusters a Flood Certifications Card. These wallet-size cards include the adjuster’s name, Flood Certification Number, and the loss categories in which the adjuster is authorized.

Qualifications

The National Flood Insurance Program (NFIP) Bureau and Statistical Agent maintains a database of NFIP qualified independent adjusters. The NFIP qualifications reflect the distinct characteristics of the NFIP coverage and adjusting requirements.

The adjuster database includes the adjuster's name and the date and location of the workshop the adjuster attended. The purpose of these workshops is to keep the adjusting community current with claims procedures required for adjusting losses under the three forms of the ***Standard Flood Insurance Policy***: the Dwelling Form, the General Property Form, and the Residential Condominium Building Association Policy (RCBAP). For this reason, all independent adjusters who wish to be certified must submit the Adjuster Certification Application. WYO company staff adjusters should be guided by their company's procedures.

The application includes five levels of authorization. An adjuster can be authorized in one or all five categories or any combination, if the adjuster's qualifications, detailed on the application, meet the requirements shown below. The five categories are as follows: Residential (Dwelling); Manufactured (Mobile) Home/Travel Trailer; Small Commercial (General Property); Large Commercial (General Property); and Condominium. All requirements are checked and verified prior to approval.

Residential, Commercial, and Manufactured (Mobile) Homes Authorization

To be approved for Residential, Commercial, or Manufactured (Mobile) Homes losses, or any combination thereof, an adjuster must: (a) have at least 4 consecutive years of full-time property loss adjusting experience; (b) be capable of preparing an accurate scope of damage and dollar estimate to \$50,000 for manufactured (mobile) homes and to \$500,000 for residential and commercial losses; (c) have attended an NFIP workshop and be able to demonstrate knowledge of the SFIP and of NFIP adjustment criteria for all policy forms; and (d) be familiar with manufactured (mobile) home and Increased Cost of Compliance adjusting techniques.

Large Commercial and RCBAP Authorization

To be approved for Large Commercial or RCBAP losses, or both, an adjuster must: (a) have at least 5 consecutive years of full-time large-loss property adjusting experience; (b) be capable of preparing an accurate scope of damage and dollar estimate of \$500,000 or more; (c) submit written recommendations from three insurance company supervisory or claim management personnel, reflecting adjusting experience only; and (d) provide information regarding current Errors and Omissions coverage.

5. "What monitoring mechanisms, if any or audits are being used to ensure these adjusters properly attributed damage as water rather than wind?"

As mentioned in item 1 above, the NFIP conducts random and on-demand re-inspections of damaged structures after each event, as well as routine audits of WYO open-claim files. For routine WYO audits, NFIP General Adjusters will randomly select WYOs for re-inspection, consider sets of claims, and randomly select claims for re-inspection.

On-demand re-inspections precipitate from FEMA directives or WYO requests, and typically arise if a homeowner on a block reports a flood claim, but homeowners adjacent to the claimant's property did not. Under such circumstances, a General Adjuster will investigate, which often leads to subsequent claim file reviews and/or additional inspections.

6. “The mechanisms NFIP has to prevent or minimize conflicts of interest by adjusters in attributing the cause of damage.”

FEMA, through the NFIP Bureau and Statistical Agent (NFIP Bureau), has a corps of special adjusters who conduct quality control reviews of claims after every flood disaster. These special adjusters go into affected areas soon after an event to assess the exact cause of a loss, and they are available to review any disputes between adjusters and claimants. Their findings are reported to FEMA and the WYO companies for any necessary corrective action. Also, as soon as possible after a storm event, the NFIP Bureau conducts adjuster meetings to discuss the specific event and identify potential coverage issues peculiar to the effected areas.

Conclusion

The 2005 hurricane season presented the NFIP with numerous challenges on a variety of fronts and provided opportunities for fundamental structural reforms, as outlined above, that are critical to the financial viability of the program.

The proposed changes to the NFIP, when integrated into a comprehensive mitigation strategy, will improve the program’s economic and financial viability. However, I want to emphasize that there is no quick solution that will enable the program to absorb catastrophic loss years as we have just experienced.

The Program’s borrowing authority currently stands at \$20.775 billion. Current expected claims payout is over \$20 billion for the 2005 storms. Additionally, the NFIP has already paid the US Treasury over \$600 million in interest on funds borrowed. The Program will continue to incur increasing interest on that borrowing.

It is also important to point out that the NFIP’s fiscal shape is not our only concern. FEMA, the Mitigation Division, the NFIP, States, communities, and citizens must do better at making sure that homes and businesses in high flood-risk areas have flood insurance coverage. The requirement that Federally-backed mortgagors in high risk areas must have flood insurance helps, but property owners without mortgages, or with other than federally backed mortgages – and very importantly – renters – are not touched by this regulatory requirement.

After Hurricane Katrina, the Gulf Coast knows that such hazards cannot be eliminated. However, through a coordinated strategy of analyzing risk, reducing risk, and insuring against risk, the impacts of flooding, as well as other natural hazard events, can be dramatically reduced. FEMA, the Mitigation Division, and the NFIP will continue strengthening our partnerships at the Federal, State, and local governmental levels, as well as with non-governmental entities and the private sector, so that future flooding events can be managed through sound mitigation planning, not disaster declarations.

I look forward to continuing to work with the Committee, our NFIP WYO companies, agent groups, and other partners to implement future changes to the National Flood Insurance Program.

I will be happy to answer any questions that the Committee might have. Thank You.