S. HRG. 109–830

THE FUTURE OF THE NATIONAL FLOOD INSURANCE PROGRAM

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST AND SECOND SESSION

ON

EXAMINATION OF THE FUTURE OF THE NATIONAL FLOOD INSURANCE PROGRAM, FOCUSING ON REDUCING LOSSES TO THE PROGRAM RESULTING FROM POLICY SUBSIDIES AND REPETITIVE LOSS PROPERTIES, AND DEVELOPING ACCURATE DIGITAL FLOOD MAPS

OCTOBER 18, 2005, JANUARY 25, AND FEBRUARY 2, 2006

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C O N T E N T S

TUESDAY, OCTOBER 18, 2005

WITNESSES

Additional Material Supplied for the Record

WEDNESDAY, JANUARY 25, 2006

WITNESSES

THURSDAY, FEBRUARY 2, 2006

WITNESSES

THE FUTURE OF THE NATIONAL FLOOD INSURANCE PROGRAM

TUESDAY, OCTOBER 18, 2005

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:30 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. This morning, the Committee meets now to hold a hearing on the future of the National Flood Insurance Program. Hurricanes Katrina and Rita have not only reminded us that flooding has been the most common and costly natural disaster in American history, but also that the Federal Government has long played an important role in planning for and reacting to flooding.

A significant part of the Federal Government's role is the National Flood Insurance Program. Established by the National Flood Insurance Act of 1968, this program works to both help flood victims recover from disasters and encourage communities and homeowners to mitigate against future floods. Despite both Federal and local government efforts, the damages from flooding, both in terms of life and property, have continued to increase. It is likely that Hurricane Katrina will be the most costly natural disaster in our Nation's history.

Flooding, however, has not been limited to the Gulf States, including mine, as we have witnessed with the recent flooding in both New Hampshire and New Jersey. The claim payments that are likely to result from recent flooding bring to the forefront many of the structural weaknesses inherent in the design of the National Flood Insurance Program. For instance, a sizable portion of properties continue to receive insurance rates that are far from being actuarially sound. Continuation of subsidized rates, particularly for properties that have suffered repetitive losses, needs to be examined closely to consider whether such subsidies encourage families to remain living in harm's way.

As FEMA currently lacks the reserves to pay the expected claims from Hurricane Katrina, I believe bringing the insurance fund to financial solvency is necessary to assure that all claims are paid in a timely and a fair manner and so that impacted families can rebuild their lives as quickly as possible.

It also appears that many flooded homes in the Gulf region were located outside the 100-year floodplain. This hearing will help us consider whether existing program requirements are sufficient to address the realistic threat of flooding from natural disasters.

Many of these issues were central to the Flood Insurance Reform Act of 2004, passed by this Committee last year. I want to recognize the leadership roles of both Senator Bunning and Senator Sarbanes in crafting that important piece of legislation. I am hopeful that this Committee can continue to build upon their efforts in addressing many of the issues currently facing the Flood Insurance Program.

We have a very distinguished panel of witnesses that I would like to welcome to the Committee at this time.

Our first panel this morning includes Mr. David Maurstad, Acting Director of the Mitigation Division, FEMA; Mr. William Jenkins, Director of Homeland Security and Justice, GAO; and Mr. Chris Landsea from the National Oceanic and Atmospheric Administration's National Hurricane Center.

Our second panel will include Mr. Robert Hunter, Consumer Federation of America; Mr. Doug Elliott, Center on Federal Financial Institutions; Mr. Robert Hartwig, Insurance Information Institute; Mr. Chad Berginnis, on behalf of the Association of State Floodplain Managers; and Professor Mark Browne from the University of Wisconsin.

I again want to thank today's witnesses here, and we will start with the first panel, but first I want to recognize Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. I want to commend you for holding this important hearing on the National Flood Insurance Program, which currently insures over 4.7 million properties in the United States.

Regrettably, I have had experience dealing with FEMA on the National Flood Insurance Program over the past 2 years, and given these interactions, I am very deeply concerned about FEMA's ability to handle not only flood insurance claims but also the other needs of the people affected by Hurricanes Katrina and Rita.

Over 2 years ago, Hurricane Isabel struck the East Coast, wreaking havoc on the lives of thousands. FEMA was clearly overwhelmed then, let alone now. Many of my constituents reported having problems settling their flood insurance claims, and, in fact, some are now suing FEMA over their flood insurance settlements.

In addition, almost 50 Maryland families remain in FEMA trailers. These are not the conditions people should have to suffer through after losing their homes and possessions. These were problems experienced after Hurricane Isabel, a much smaller event than the ones FEMA is currently dealing with, where the estimates are that a million people have been displaced. FEMA estimates that over 200,000 flood claims will be filed.

I have called on the President to provide housing assistance to families through HUD in this Nation's housing delivery system. I do not think FEMA can deliver 18 months of housing assistance for hundreds of thousands of people. Putting this responsibility on FEMA, an agency already under strain, is a recipe for disaster. You can see it from the news reports every day.

I am also concerned about the handling of flood claims, especially since FEMA has not implemented many of the critical reforms Congress passed in response to the problems after Hurricane Isabel. We held hearings, Senator Bunning crafted legislation, but FEMA has not put the provisions of that legislation fully into place. Almost a year since the statutory deadline, FEMA has not adopted minimum education and training requirements for insurance agencies, something Congress found was specifically necessary to ensure consumers receive accurate information about flood insurance and their policies.

In addition, while FEMA has finally published the required Claims Handbook, a critical element of this handbook and the claims process is missing. The Committee found after Hurricane Isabel struck over 2 years ago that flood victims had no adequate means to make complaints or appeal decisions. I am dismayed to learn that there is still no formal appeals process for holders of flood insurance policies. It has not been formalized within the statutory timeframe, and while FEMA has now issued the handbook, it does not contain an appeals process.

Hurricanes Rita and Katrina and the recent floods in the Northeast will place even greater strains on the Flood Insurance Program than we have seen in the past. I gather the current estimates are that we will have over $20 billion in flood insurance payouts, more than has been paid out in flood insurance claims since the program began in 1968.

So, I think this review of the Flood Insurance Program is obviously timely. There are many issues that need to be looked at: Why many property owners do not have flood insurance, the rates of coverage are quite low. Although mortgage lenders must ensure that homeowners have flood insurance in flood zones, there is no system in place to ensure that homeowners keep the coverage in force. And many properties that lie outside of the special flood hazard areas are flooded, so we need to look at how we define mandatory purchase zones and assess whether requiring coverage only for those properties within the 100-year flood zone makes sense.

The state of the flood maps is apparently woefully inadequate. FEMA is in the midst of map modernization, but the State people tell us that these maps really do not fully reflect the true risk to life and property.

There is some concern about FEMA staffing and resources and whether placing it within the Department of Homeland Security means that it is being neglected in that regard. I think that is an important issue to look at as well.

So, Mr. Chairman, obviously a number of issues have arisen. Again, I want to emphasize my concern that the reforms that I worked with Senator Bunning and others to formulate and that we moved through have not been fully implemented by FEMA. And some of those were quite important indeed, and obviously we want to know why that is the case and what can be done about it. It ought not to take another catastrophe to put some of these things into effect.

Thank you very much.

Chairman SHELBY. Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. I have no statement at this time. I just want to join the Chairman in welcoming our witnesses.

Chairman SHELBY. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you, Mr. Chairman, and I would just like to make two points.

In following up on Senator Sarbanes' comment, one of the problems we have is that the maps that are being used, the FEMA map and the Corps of Engineers map, are not consistent. The FEMA map describes a 100-year flood. The Corps has inundation maps of actually used scenarios of Class 2 and 3 hurricanes. And in my home State of Rhode Island, in fact, in every area in the country, you can think you are secure if you look at the FEMA map because you are outside the flood zone. But if you look at the Corps of Engineers map, a Class 2 hurricane, you are going to get flooded. I am working on legislation. I think these maps should be coordinated, and the information should be provided to homeowners and to insurers. And I think also we should be encouraging more homeowners who could be flooded to get this insurance, as Senator Sarbanes suggested. And that is something I think we can do very practically and we should do.

The other point is the fact that we all recognize that there is increased building along wetlands, oceans, and beaches. Again, I think my State is not unique. I would expect that along the Alabama coast you have seen a lot more houses, and the Maryland coast. I do not know about you, Senator Bennett, but certainly along our coast we have seen a lot of building along the coastline.

Senator BENNETT. We have had some rivers go out of their 100-year——

Senator REED. Floodplains.

Senator BENNETT. And cause floods.

Senator REED. Into the new subdivisions.

Senator BENNETT. That is right.

Senator REED. And so we have to begin to think very seriously about how we balance this new growth with the dangers of flooding and are we giving incentives that complicate our problems with flooding. And I think that is something that, in a general topic, we should address.

But I thank you very much, Mr. Chairman. This is a very important hearing. As we speak—and I think everyone is aware of it if you watched some television this morning—there is a dam that is under great stress in Taunton, Massachusetts. If it gives way, there could be serious flooding up the 10-plus miles from the Rhode Island border. So this is not an academic subject today.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman, for holding this very important hearing, and I would like to thank all of our witnesses for coming before us today.

We all saw the heartbreaking images of the devastation caused by Hurricanes Katrina and Rita. Americans have opened their hearts and their wallets to help those whose lives have been turned upside down by those storms. I know the Chairman has been personally affected by the plight of his constituents. We are still cleaning up the mess, but we are also starting to rebuild the homes and lives of those affected.

One critical tool to rebuild the Gulf is the National Flood Insurance Program. On June 30 of last year, the President signed into law the Reauthorization of the National Flood Insurance Program. We worked very hard on that bill, and I think we made a good product.

Mr. Chairman, you were instrumental in passing that bill, as was Senator Sarbanes. After Hurricane Isabel devastated parts of Maryland, we learned a lot about what improvements could be made to the Flood Insurance Program to make it work better for policyholders. Senator Sarbanes was instrumental in writing Title II of the bill.

Title II, when implemented, will provide policyholders with much needed protection, including, I think most importantly, an official appeals process. Unfortunately, the key words in that last statement is "when implemented." Despite it being almost 16 months after the President signed the bill and 10 months after the statutory deadline, FEMA has not implemented the consumer protection called for in this law. FEMA has not even put out proposed regulations for comment.

I know they finally put out the guidebook that Senator Sarbanes talked about for Title II last month, but that booklet is incomplete because it does not tell policyholders about an appeals process. Of course that appeals process does not exist yet, which is a violation of the law. This is completely unacceptable.

After the Isabel experience we tried to learn from our mistakes and make the program more user friendly before the next storm. Unfortunately, FEMA did not. The protections are still not in place. Many policyholders do not know that unlike in homeownership insurance, the contents of their homes are not covered unless they bought a separate content policy, and as I already mentioned, there is no official appeals process. Hopefully, our witnesses can answer some of the $64,000 questions that have plagued this program.

How do we get more people to participate in the program, and how do we make sure everyone who should be in the program is in the program? We must assure the program is shored up after this hit, and maybe FEMA will tell us if they ever have any idea when they will put out for comment the proposed regulations required under last year's reauthorization. I may ask when the final rules will be implemented, though I am pretty sure they do not have a clue.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Carper, you have any comments?

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Just briefly. I have a sense of déjà vu, a long time ago when the Chairman and I served on the House Banking

Committee, this was an issue that I had a great deal of interest in, and that was almost 20 years ago, and we are still back at it and trying to figure out——

Chairman SHELBY. We were younger then.

Senator CARPER. Yes, we were.

But I was pleased to support Senator Bunning's legislation last year in a belief that it would help get us close to where we tried to go some 15 years ago, and I am very much looking forward to the testimony of our witnesses today to find out what is being done, what needs to be done, how do we get this thing moving so we can better protect homeowners, but at the same time better protect the Treasury.

With that having been said, I welcome our witnesses, and we look forward to your testimony and a chance to ask you some questions.

Thank you.

Chairman SHELBY. Thank you, Senator Carper.

I have introduced the panel already. We will start with Mr. Maurstad.

Senator DOLE. Mr. Chairman.

Chairman SHELBY. Senator Dole, sorry. You do have a lot of coastline in North Carolina.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Mr. Chairman. I first want to associate myself with Senator Bennett's statement earlier this morning on the importance of moving forward with TRIA.

I ask unanimous consent that a statement from the National Association of Realtors on the Flood Insurance Program be entered into the record.

Chairman SHELBY. Without objection, it will be made part of the hearing record.

Senator DOLE. I am particularly pleased that we are examining the future of the National Flood Insurance Program this morning, Mr. Chairman. Folks in North Carolina know that I have been a strong advocate of this program, which covers approximately 147,000 homes in our State.

North Carolina has certainly felt the impact of flooding, as you mentioned, in the wake of powerful hurricanes like Isabel, Frances, Ivan, and just last month, Ophelia. Ophelia hit the coast, resulting in a great deal of flooding as well. Indeed, no one could have foreseen the strains that Hurricanes Katrina and Rita would place on the program. As of September, FEMA has $3½ billion in borrowing authority to help pay the claims resulting from these two hurricanes. But according to FEMA, we now expect between $15 and $25 billion in claims. This makes it clear that we are going to again need to raise the borrowing authority for the program, and we should not hesitate to do so.

In the aftermath of these most recent tragedies, we must redouble our efforts to make certain that wherever possible homes are rebuilt stronger, higher, and safer than before to prevent repetitive losses and to save lives in the future.

In my 8 years as President of the American Red Cross, we took a leadership role and worked as a full partner in FEMA's efforts to develop and implement a national mitigation strategy, and we also co-sponsored FEMA's biannual National Mitigation Conferences. We appointed the first ever Assistant Director for Mitigation, who worked closely with FEMA's Deputy Federal Coordinating Officer for Mitigation and advocated for these policies and actions at the local, State, regional, and national levels. After all, mitigation not only prevents or greatly minimizes damage, mitigation but also saves lives.

Now more than ever we must ensure that this important work on mitigation is emphasized as we rebuild, and that it continues in the areas most vulnerable to flood loss across the Nation.

Finally, mapping plays an integral role in mitigation efforts. Last year's reauthorization included nearly $1½ billion in flood map modernization funding through 2008. These maps helped determine the exact size of our floodplains and they are essential to proper planning for our communities. The Government has committed to a 50/50 partnership with the States and it is essential that these efforts continue.

I am proud that North Carolina has one of the most advanced mapping programs under way. I look forward to continuing our work on these issues as our recovery efforts continue, Mr. Chairman. Families certainly deserve the security and the peace of mind that the National Flood Insurance Program provides.

Thank you.

Chairman SHELBY. Thank you, Senator Dole.

All of your written testimony will be made part of the hearing record in its entirety. Mr. Maurstad, we will start with you.

STATEMENT OF DAVID I. MAURSTAD ACTING DIRECTOR AND FEDERAL INSURANCE ADMINISTRATOR, MITIGATION DIVISION, FEDERAL EMERGENCY MANAGEMENT AGENCY, EMERGENCY PREPAREDNESS AND RESPONSE DIRECTORATE, U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. MAURSTAD. Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I am David Maurstad, Acting Mitigation Division Director and Federal Insurance Administrator for FEMA within the Department of Homeland Security. I appreciate the opportunity to appear today before the Committee.

Hurricanes Katrina and Rita left devastation in their wake beyond any natural disaster in our Nation's history. The impact of these events will be felt for some time, and my thoughts and prayers are with those who have been personally impacted.

The magnitude and severity of flood losses related to Katrina and Rita are unprecedented in the history of the NFIP. The challenges these storms have presented in terms of flood insurance claims handling, floodplain management, mitigation planning, and grants management, have never been encountered on this scale before.

Let me provide a context for what the NFIP and the Nation is facing. Since the NFIP's inception in 1968, $15 billion has been paid out to cover more than 1.3 million losses. In 2001, Tropical Storm Allison resulted in the NFIP's first billion-dollar storm with over 30,000 claims received, totaling $1.1 billion. Just last year, the

2004 hurricane season resulted in a record number of claims, over 75,000, totaling close to $2 billion paid out in NFIP coverage, again, a record amount.

We estimate that Hurricanes Katrina and Rita will result in flood insurance claims at least 8 times the highest number filed from any single event in NFIP's history, and well more than triple the total number of claims filed in 2004. Currently, there are 20,100 communities in all 50 States and U.S. territories participating in the NFIP. The program collects slightly more than $2 billion in premium and fees from 4.7 million policyholders, insuring in excess of $800 billion in assets. It is important to note that since 1986 the NFIP has been financially self-supporting. During periods of high losses, the NFIP has borrowed from the U.S. Treasury, and this is an essential part of NFIP's financing for heavy loss years. These loans have been repaid with interest from policyholder premium and related fees at no cost to the Nation's taxpayers.

This catastrophic event goes well beyond what the NFIP was intended to address from premium revenues alone. A recent claims payment projection, which was submitted for the record, indicates that more than 225,000 flood insurance claims may be filed, resulting in an estimated $23 billion in payments. This $23 billion in estimated claims from those whose homes and businesses have been damaged or destroyed by these hurricanes is not a new obligation. It is the result of a legal promise we made to these homeowners and business owners when Congress passed the National Flood Insurance Act of 1968 and subsequent revisions.

Homeowners and business owners agreed to pay premiums. Communities agreed to adopt building codes to mitigate flood damages, and the Federal Government agreed to provide insurance coverage to policyholders after a disaster. Every single one of these claims represents someone who has taken a responsible course of action by purchasing flood insurance and faithfully paying the premiums. We not only have a legal obligation to honor our commitments, but we also have a moral obligation to provide the coverage that we promised.

On September 20, 2005, the President signed H.R. 3669, which increased the program's borrowing authority from $1.5 billion to $3.5 billion. However, as Hurricanes Katrina and Rita related claims will exceed this amount by a substantial margin, we request that an additional $5 billion be added to this authority. This stopgap measure should allow sufficient borrowing authority to cover claims through mid- to late-November, and also would enable us to work with this Committee and others to complete meaningful program reform recommendations.

The NFIP has been a long-term commitment for changing the way we reduce the Nation's flood risk. As we move forward toward the future we are using the following principles to guide us in formulating those recommendations: Protecting the NFIP's integrity by covering existing commitments and liabilities, charging fair and actuarially sound premiums for all policyholders by phasing out subsidized premiums, increasing program participation incentives and improving enhancements where mandatory participation is warranted, increasing risk awareness among homeowners and consumers by improving information quality, and reducing future risks through a combination of mitigation measures, and by exploring opportunities to reduce risk through enhanced protective measures.

Consistent with the first principle, I have established policies that enabled, simplified, and streamlined processes to help policyholders settle their claims quickly. Using these streamlined methods we expect to substantially reduce our adjustment times from what you would expect under such extreme circumstances.

Starting September 1, to help policyholders through the claims process, two updated documents have been made available, the NFIP Summary of Coverage, and the Flood Insurance Claims Handbook. With the Committee's permission, I would like to submit copies of these documents into the record.

Chairman SHELBY. Without objection, will be made part of the record.

Mr. MAURSTAD. As the focus shifts from response to recovery, the areas impacted will begin to consider opportunities for rebuilding a less vulnerable coast. However, the overwhelming desire to rebuild immediately must be balanced with the need to rebuild wisely. A significant part of FEMA's Gulf Coast mitigation strategy is based on effective planning and encouraging communities to rebuild stronger and safer.

The NFIP Community Rating System will play a major role in this effort. FEMA will also continue to address repetitive loss properties including severe repetitive loss properties as authorized by Title I of the 2004 Flood Insurance Reform Act. Removing repetitive loss properties from the NFIP policy base will be a significant step toward improving the financial health of the National Flood Insurance Fund.

Sound floodplain management, planning, regulation, save this country an estimated $1.1 billion in prevented flood damages annually. This means that since 1996 the Nation has reduced the risk of flood loss by $10 billion.

After seeing the devastation of the hurricanes firsthand, I have a clear understanding of the challenges we face as a Nation. The Department of Homeland Security, FEMA, the NFIP, and our partners are committed to working closely with the Gulf Coast States, local governments, communities, and private sector entities during what will be a long recovery and rebuilding process.

I will be pleased to answer any question Committee Members may have.

Chairman SHELBY. Thank you.

Mr. Jenkins.

STATEMENT OF WILLIAM O. JENKINS, JR.
DIRECTOR, HOMELAND SECURITY AND JUSTICE ISSUES,
U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. JENKINS. Chairman Shelby, Mr. Sarbanes, and Members of the Committee, I appreciate the opportunity to be here today to discuss the challenges facing the National Flood Insurance Program.

The devastating effects of Hurricanes Katrina and Rita have placed unprecedented demands on the NFIP. As of October 13, FEMA reported that 192,809 claims had been filed, and NFIP had paid almost $1.3 billion to settle 7,664 of these claims.

The NFIP combines property insurance for flood victims, maps to identify the areas at greatest risk of flooding, and incentives for participating communities to take actions that reduce future flood damage. Two key goals of the NFIP are, one, to maximize the use of insurance rather than taxpayer funded disaster assistance for repairing and replacing flood-damaged property, and two, reduce the potential for future flood damage through floodplain management and building code regulations and enforcement.

A key characteristic of the NFIP is the extent to which FEMA must rely on others to achieve the program's goals. FEMA's role is primarily to, one, establish policies and standards that others generally implement on a day-to-day basis, and two, provide financial and management oversight of those who carry out these day-to-day responsibilities. Those daily responsibilities include ensuring that property owners who are required to purchase flood insurance do so, developing and revising flood maps, enforcing floodplain management and building code regulation in participating NFIP communities, and selling and servicing flood insurance policies.

Our prior work has identified several NFIP challenges. First is reducing program losses resulting from policy rate subsidies and repetitive loss properties. The NFIP does not collect sufficient premium income to build reserves to meet long-term future expected flood losses, in part because Congress authorized subsidized insurance rates to be made available for some properties, many of which have had repetitive claims.

Premiums are set to cover losses for an average claim year, which until 2004 has generally been sufficient to pay claims. Repetitive loss properties account for approximately 1 percent of all insured properties, but as much as 30 percent of all claims payments. To address this issue, the Flood Insurance Reform Act of 2004 established a pilot program that would provide funds to elevate, relocate, or demolish such properties with NFIP bearing a substantial portion of the cost. Those who refuse to participate can have their premiums raised up to the actuarial rate for the area in which they are located.

The success of this program should be carefully evaluated to determine how well it works and what changes if any are needed to increase its effectiveness in reducing costly repetitive loss properties in the program.

Second, increasing property owner participation in the program has been a historic challenge. Half, perhaps less, of eligible properties may be covered by flood insurance. In 2002, we found it was not possible to reliably determine the extent of compliance with the applicable mandatory purchase requirement. Our work also suggests that higher premiums, which could enhance the program's financial stability, may result in fewer voluntary insurance purchases, thus increasing taxpayer exposure when flooding occurs.

Third is the challenge of developing and maintaining accurate digital flood maps which are the very foundation of the NFIP. FEMA must ensure that floodplain maps accurately identify the areas at highest risk of flooding, the areas in which flood insurance is required. It must also ensure that communities at comparable risk of flooding have maps of comparable and useful accuracy.

Fourth, providing effective oversight of flood insurance operations. In the report we that are releasing today, we note that FEMA faces a challenge in providing effective oversight of the 95 insurance companies that are primarily responsible for selling and servicing flood insurance policies. The record number of claims resulting from the recent hurricanes only reinforces the importance of effective oversight and the need for a clearly defined, understandable, and consistently applied process for policyholders to file and appeal claim settlements.

In conclusion, FEMA and Congress face a complex challenge in assessing potential changes to the NFIP that would improve its financial stability, increase the proportion of property owners at risk of flooding to purchase flood insurance, reduce losses from repetitive loss properties, and maintain accurate and current maps of floodplain boundaries. These issues are complex, they are interrelated, and addressing them is going to involve tradeoffs and the cooperation and participation of all key stakeholders, both public and private.

That concludes my statement, Mr. Chairman. I would be pleased to respond to any questions you or other Members of the Committee may have.

Chairman SHELBY. Thank you, Mr. Jenkins.

Dr. Landsea.

STATEMENT OF CHRIS LANDSEA
TROPICAL PREDICTION CENTER/
NATIONAL HURRICANE CENTER,
NATIONAL WEATHER SERVICE,
NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION,
U.S. DEPARTMENT OF COMMERCE

Mr. LANDSEA. Good morning, Mr. Chairman and Members of the Committee. Thank you for inviting me the discuss the outlook for hurricane activity and the storm surge and flooding associated with hurricanes. I am Chris Landsea, the Science and Operations Officer at the National Hurricane Center, part of the National Weather Service of NOAA.

With the Chairman's permission, I request the that clerk provide these handouts to the Committee.

Chairman SHELBY. The clerk will do that.

Mr. LANDSEA. Hurricanes are fueled by warm water as they travel across the ocean. If atmospheric winds allow, an abundance of warm water provides more energy, causing the storm to increase in strength. In recent decades, the United States has experienced relatively few hurricane landfalls, and in particular, very few major hurricanes, those of Category 3 or higher on the Saffir-Simpson Hurricane Scale.

Our good fortune ended last year when 6 hurricanes hit the United States and 3 of those were major hurricanes. The 2005 season has been one of the most active on record with 21 tropical storms, 11 of which have become hurricanes, and 5 of those have been major hurricanes. Three of these major hurricanes, Dennis, Katrina, and Rita, struck the United States.

Based upon changes in oceanic and atmospheric conditions, we believe this increased activity is due to a natural cycle called the

Atlantic Multidecadal Mode. It is a shift in the surface temperature and the wind structure of the North Atlantic and Caribbean Sea between warm and cool phases, each phase lasting 25 to 40 years. Data suggests that we are currently in a warm Atlantic phase, thus an active Atlantic hurricane era is under way similar to that last seen from the late 1920's to the late 1960's.

Our research suggests that many of the hurricane seasons in the next two to three decades may be much more active than they were in the 1970's through the early 1990's. Warmer sea surface temperatures and less destructive atmospheric winds are expected to contribute to conditions that foster increased hurricane development over this period.

While anticipating a busy era in coming hurricane seasons, we do not expect every year to be hyperactive. But because of this heightened storminess, we should continue to be threatened by destructive hurricanes with the potential for loss of life when they do strike. This is of particular concern because of the increasing populations living in vulnerable coastal regions.

Both storm surge and inland flooding pose significant challenges to both coastal and inland companies. Storm surge is where the water is pushed over the shoreline by the force of the winds associated with the hurricane. Because much of the densely populated U.S. Atlantic and Gulf coastal communities lie less than 10 feet above sea level, the danger from storm surge is tremendous. As experienced with Hurricane Katrina, storm surge can be a deadly aspect of hurricanes for which we need to be prepared.

Freshwater floods from rain present another great threat to life and property in hurricanes. Two types of inland flooding occur from these storms, flash flooding and river flooding. Flash flooding occurs in creeks, streams in urban areas within a few minutes or hours of excessive rainfall. Rapidly rising water in confined valleys or canyons can reach heights of 30 feet or more. River flooding occurs from heavy rains associated with decaying hurricanes or tropical storms, and in extreme cases, river floods can last a week or more.

We have taken steps to improve our forecasts of rainfall amounts, extended those forecasts out for 5 days, and incorporated those rainfall forecasts into our river and flood predictions. The National Weather Service conveys the magnitude of observed or forecast flooding using flood severity categories, including minor, moderate, and major. Each category has a definition based upon property damage and public threat.

The National Weather Service precipitation frequency estimates are used as design standards for civil infrastructure built to cope with rainfall and runoff, such as stormwater drainage systems, roads, and small dams. These precipitation frequency estimates also contribute to computing flood insurance rate maps and various planning activities.

NOAA strives to improve the reliability, accuracy, timeliness, and specificity of predictions of hazardous weather, such as hurricanes, to help our society cope with these phenomenon.

Over the last 15 years, hurricane track forecast areas have decreased by 50 percent, largely due to advances in hurricane modeling and technology, a better understanding of hurricane dynamics and increased availability of data from the region around the hurricanes.

In addition, using a combination of atmospheric and oceanic hurricane observations from satellites, aircraft, and all available surface data over the oceans, we conduct experiments to better understand internal storm dynamics, interactions between a hurricane and its surrounding atmosphere and ocean.

Predicting hurricane intensity remains one of our acute challenges. To advance hurricane prediction, NOAA is developing the Hurricane Weather and Research Forecasting System. This system uses a collaborative approach among the research community with a goal of coupling an advanced wave model with a dynamic storm surge model to better predict coastal impacts of waves and storm surge.

We have also increased our efforts to transfer research into operations. The U.S. Weather Research Program Joint Hurricane Testbed was formed in 2000. The mission of this testbed is to facilitate the transfer of new technology, research results, and observational advances for improved hurricane analysis and prediction. A large portion of my job at the National Hurricane Center is to facilitate and test these new projects for possible implementation.

Thank you, Mr. Chairman, and Members of this Committee, for the opportunity to discuss the outlook for hurricane activity and the storm surge and inland flooding associated with hurricanes.

I would be happy to address any questions. Thank you.

Senator SARBANES. Mr. Chairman, could I just put a technical question?

Chairman SHELBY. Go ahead.

Senator SARBANES. Is the definition of a hurricane, as reflected in this chart, consistent from 1944 forward?

Mr. LANDSEA. It is. The definition of a hurricane is with winds of at least 74 miles per hour. The graph that you have is the major hurricanes, the Category 3's, 4's, and 5's. Those are with winds of at least 111 miles per hour.

Senator SARBANES. They were defined the same way back here as they are now; is that correct?

Mr. LANDSEA. Well, that is part of the problem, is knowing the past data is sometimes problematic because our understanding has changed of hurricanes in the past. So we think it is equivalent, but it does need to be reanalyzed.

Senator SARBANES. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. That was a good question.

Mr. Maurstad, I believe the hurricane forecast we just heard from Dr. Landsea is quite a sobering one. Throughout most of the existence of the Flood Insurance Program, we have been in a period of relative calm hurricanes. That period appears to be over, at least for the future. To what extent does FEMA take future weather forecasts into account when setting rate premiums?

Mr. MAURSTAD. The actuarial basis is a look at what the experience has been for the particular rate classes, and tries to anticipate——

Chairman SHELBY. And experience how far back? How far do you relate back on this?

Mr. MAURSTAD. We use what data is available based on experiences for the program, and that changes as different events—for example, in 2004 when that data is included in our rates for the upcoming year, that will certainly change the experience and the numbers that the actuaries will use in trying to determine what the appropriate amount of premium to generate should be. There is an element of also trying to look to what the future may hold, but it is not as great an element as the mathematical statistics that are developed.

Chairman SHELBY. Dr. Landsea, your testimony, among other things, pointed out that an active hurricane season does not necessarily mean more storms make landfall. Could you expand on that for the Committee, on some of the factors that determine whether a hurricane reaches land or not? Is that just luck if it does not?

Mr. LANDSEA. It is partly luck. What we see is that ones that hit land are a factor of whether they form, the steering that they undertake. And so some years, like 1995, we have a large number of hurricanes, but because of the steering patterns pushing them back out to sea, we do not have a lot of issues in the United States. And then there are years like this year and last year where most of them seem to be heading toward the United States.

Chairman SHELBY. Mr. Maurstad, this Committee has heard a variety of assertions about who in the Gulf States, including my State of Alabama, had flood insurance, who did not, and whether areas impacted by Hurricane Katrina were within special flood hazard areas. To what extent did families in Katrina areas have flood insurance, and do we know how many homes were flooded by Katrina, and how much of the impacted area was considered to be within a special flood hazard zone, and hence, subject to the mandatory purchase requirements?

Mr. MAURSTAD. Well, First if I could, I want to make sure that my previous question that we look at more than just the insurance experience in determining what the rates are, that there are engineering studies, a full range of expectations are included in that actuarial determination of what the rates are.

Chairman SHELBY. And by engineering studies, what do you mean, what the Corps does?

Mr. MAURSTAD. What engineering studies relative to the amount of damage that is caused by surge, by collecting data at the site of the damaged area, that type of information. And that actual hurricane data that we use goes back 100 years. So it is more than just since the program started.

But to get at your question of how many people had flood insurance in the affected areas, in the special flood hazard area, what I would like to do is—because we are continuing to gather that information—get that information and provide it to your Committee.

Chairman SHELBY. Will you provide that for the Committee?

Mr. MAURSTAD. Yes, I will, sir. I can say that—if I can move from Louisiana east, that in the parishes affected in Louisiana, there is a higher percentage of people with policies than what you generally will see in most areas of the country.

Chairman SHELBY. Is that because there are so many more areas below sea level?

Mr. MAURSTAD. Yes, sir. And in the Mississippi Gulf Coast area the estimation is, and the Alabama Coast area, about a third of the people had a flood insurance policy. One of the challenges that we have is to make sure that people here—what we are trying to communicate to them as accurately as possible, in that the special flood hazard areas are those areas on the rate maps that are at the highest risk, and that just because you are not in a special flood hazard area does not meant the you are not subject to risk of a flooding event.

Chairman SHELBY. Did we not witness some of that in Mississippi, that areas that had never been flooded, not that we knew about?

Mr. MAURSTAD. Our current gathering of the data at this time shows that in some of the areas across the Gulf Coast area this was 1,000-year event or beyond. In some of the areas it was a 250-year event, and so areas were affected by storm surge that previously had not been considered at that great of a risk, not at zero risk, but not at that great of a risk. And so we use events like this to learn and to try to make improvements as we move forward.

Chairman SHELBY. Under current law, mortgage lenders are required to make sure federally related mortgages have flood insurance. Mr. Jenkins, you stated in your testimony that the existing data on lender compliance with the Flood Insurance Program's mandatory purchase requirement is inconclusive. Do you have any suggestions as to how either the bank regulators or FEMA could better measure compliance with this requirement, and are there additional statutory changes that could increase the level of compliance with the mandatory purchase requirement?

Mr. JENKINS. There are a couple of issues here I think. One of the things that affects being able to track compliance is the fact that the agency that services the mortgage changes. Very rarely is it the person or the agency that initially issues the mortgage. This does not seem to be much of a compliance issue in terms of when the mortgage closes. In other words, you close on the house or the property, and usually flood insurance is included at that point. It is maintaining the flood insurance and knowing that you maintained the flood insurance that is an issue. As the servicer changes, that can get lost in the shuffle and people then can drop it without it being known that they have dropped it.

So one of the issues is making sure that there is a central point of accountability, whether it is the initial lender or some other person that has responsibility for making sure that this——

Chairman SHELBY. Is it today? Is that central point of accountability prevalent?

Mr. JENKINS. It is not clear that it is prevalent. I mean it is certainly true that as a result of the 1994 Act, that a lender has to make sure that that insurance is retained, but it is not clear exactly to the extent to which that is actually the case, and that is what we found. It was very difficult to find out.

Chairman SHELBY. Who checks on that? Who is accountable here to make sure this Act is complied with?

Mr. JENKINS. The lender that made the loan is, at least under the 1994 Act, accountable for that. So they are the ones.

And then the other issues, which is not so much whether or not they maintain the mandatory insurance, but as you know, the mandatory requirement is only for the outstanding balance of the mortgage. So as the mortgage is paid down, if you are just doing what you need to do, then the amount of your coverage is going to go down and your exposure is going to go up for the uninsured portion of your property——

Chairman SHELBY. Have you done studies, or do you have access to studies, where once the mortgage is paid off, for example, that that is the end of the flood insurance, that the homeowner does not carry the insurance anymore?

Mr. JENKINS. I really do not have any data. We have not done any studies looking——

Chairman SHELBY. Should we not have that data?

Mr. JENKINS. I think we should have that data, yes, but we do not. It is very difficult and there are lots of different studies out there. The studies that we looked at were not nationwide for the most part, they were in specific counties or specific groups of counties, or a particular lender had done its own study to look at what was going on with its loans. So there is no source of national data which——

Chairman SHELBY. No definitive study.

Mr. JENKINS. Right, no definitive study of which we are aware.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Mr. Jenkins, this report which the GAO is releasing that was mandated by the Act, as part of that study, GAO was supposed to look into the problems experienced by policyholders after Hurricane Isabel.

Mr. JENKINS. Right.

Senator SARBANES. Now, as I understand it from your testimony, the report was based on interviews with FEMA officials as well as with review of FEMA data and files; is that right?

Mr. JENKINS. That is correct.

Senator SARBANES. In GAO's review, were interviews held with policyholders, those who had direct experience with FEMA after Hurricane Isabel?

Mr. JENKINS. No, we did not interview policyholders specifically.

Senator SARBANES. Why not?

Mr. JENKINS. Part of the problem with interviewing the policyholders is the time that the work started, the time we got work started. We were concerned about being able to validate the information that we got, and so what we wanted to do is be able to look at information that we could get from those people, or at least from those files of people who appealed their policy claims to FEMA through the appeals process and what happened. That was what was documented consistently in terms of what their concerns were, what issues that they raised, why they thought their initial claim settlement was——

Senator SARBANES. Documented by whom?

Mr. JENKINS. By the policyholder, that is, the policyholder who filed the appeal, put in writing why they thought the initial claim was unsatisfactory. And so we wanted to look at that because that is what they documented, it is what they had on record, it is what they considered their most serious concerns with regard to their initial settlement and why they thought that settlement should be changed.

Senator SARBANES. I know, but you are reviewing the whole FEMA process. I have difficulty in understanding why you would not talk to some of the people who had these complaints and were the victims.

Mr. JENKINS. We decided, as I said, and we discussed this with the Committee, I mean with Committee staff as we were going forward with the study, that we were concerned about the consistency of the data.

Now, we do have, as a result of what is going on now, teams in each of the four Gulf States, who are interviewing hurricane victims as well as Federal, State, and local officials, and flood insurance is one of the issues that they are getting. That information is more real time, and that was one of our concerns with Isabel, was the time that had passed since the events had occurred.

Senator SARBANES. Well, it seems to me you should revisit that. I mean I think, as I understand it you had some concern about whether the victims' views would, "be objective," but your job is to weigh what you hear, but I mean they are going to bring things to your attention that you might otherwise be aware of. These complainants are being left out of the process everywhere we turn. Do you agree with us that there is not a formal appeals process that has been put in place by FEMA?

Mr. JENKINS. At this point, that is correct.

Senator SARBANES. That is correct, right. The statute required a formal appeals process. We do not have that in place. So the people cannot work up a ladder and get through process, so to speak. In fact, I am told FEMA says to them, "Well, you can go to court." Of course they can go to court, but that is a big step to go to court. It costs a lot of money. A lot of people cannot entertain that step, and they have been hit hard, and they are struggling and then they run into all these kind of problems.

So, I commend to you maybe the possibility of revisiting this judgment about talking to the complainants.

The next question I want to put to both you and Mr. Maurstad, is that I am told that the administrative fees in writing these flood insurance policies, the so-called "write-your-own-insurers," run as high as 30 percent. Is that correct?

Mr. JENKINS. That is right, about 30 percent of the premium, and then they get about 3 percent of any claims that are paid.

Senator SARBANES. How does that compare with the administrative costs of other types of insurance?

Mr. JENKINS. I am not really quite sure. It depends on the instruments. For example, certain kinds of whole life policies, that the agent gets 100 percent of the first-year premium, so in those cases it is lower. I do not know how it compares to other kinds of casualty policies or property loss policies.

Senator SARBANES. Would you regard these administrative costs as being particularly high?

Mr. JENKINS. Because we have not looked at that compared to others, I really do not have a fact basis for answering that.

Senator SARBANES. Mr. Maurstad, what is your take on this?

Mr. MAURSTAD. Well, the issue is, other than maybe some State wind pools, there is not a circumstance that is similar to how an insurance program is provided. We rely on the 96 write-your-own insurance companies to administer this program on behalf of the Federal Government. They write the policies under their name. They market the policies. They sell the policies. They reimburse their agents. They handle the claims. They administer the program. Ninety-five percent of all the policies written, they administer, and that is the cost to the program for using the private insurance sector as our administrator of the program.

Senator SARBANES. On what basis do you evaluate whether the administrative costs incurred in this program are reasonable or whether FEMA is being—I do not want to use a pejorative term like "ripped off" or something, but is FEMA overpaying with respect to administrative costs.

Mr. MAURSTAD. We rely on those 96 write-your-own companies to—in fact, they are the basis, the foundation for the National Flood Insurance Program. It has been tried other ways, but they in fact are the mechanism by which we can distribute policies to people in all 50 States. We look at the A.M. Best rating for the cost associated, the expense cost associated, put out by the A.M. Best Company, and use that as a guide. I suggest sense that part of that is the agent commission reimbursement that is more than likely in the 15 percent range. So believe me, we watch and oversee this very carefully to make sure that there is an appropriate balance in making sure that there is enough paid to the companies so that they in fact voluntarily choose to participate in this program.

Senator SARBANES. Mr. Hunter is going to be on the next panel. Mr. Maurstad, are you familiar with Mr. Hunter?

Mr. MAURSTAD. Yes, sir.

Senator SARBANES. He says about this program, "It appears to be terribly expensive." Then in a footnote to that he says, "I have not been able to get current data from FEMA on this point. I have a call in to FEMA for the latest information, will supply it to the Committee when I get it, if I do get it. The Committee should ask for this information from FEMA to determine the program's actual cost. I suggest not only looking at the cost of service compared to that of a competitively bid contractor, but also to compare the cost of that of private insurers selling homeowner insurance, a more complex problem than flood insurance, and more costly to produce, since homeowners insurance is not simply added to a policy as WYO flood insurance is."

Mr. MAURSTAD. Well, sir, we look at the expense allowance, and that expense allowance is set primarily with 15 percent under the premise that 15 percent goes to the agent that is out in the field, and 15 percent goes to the company, and that expense allowance is set based on the review of equivalent lines of business, the homeowners, farm owners, a commercial multiperil, so that we are compensating the companies fairly, again for them to provide a very valuable service to the program because, for example, a single contractor would not have the distribution system in place, the thousands of agents across the country that these 96 write-your-own companies have, just to start with just the distribution of it, the availability regardless of where one lives, to have flood insurance be made available to them.

Again, we look at this very carefully. I believe that we are fairly compensating the companies for the valuable service that they provide this program.

Senator SARBANES. We will have a chance to explore that when the next panel comes before us.

Mr. MAURSTAD. Yes, sir.

Senator SARBANES. Let me just run through very quickly—my time is up—but FEMA was required to develop an acknowledgement form to be signed by every insured person that they have received the flood insurance policy detailed description of its coverage. Has that been done?

Mr. MAURSTAD. That is in the process of being implemented. Effective October 1, the companies will be doing that on the first batch of renewals that will occur either late November or early December, so that is in place.

Senator SARBANES. It was supposed to have been implemented last December; is that correct?

Mr. MAURSTAD. Yes, sir.

Senator SARBANES. FEMA is required to establish a formal appeals process by December 30, 2004. Was that done?

Mr. MAURSTAD. No. Well, if I could take a moment, Mr. Chairman, and respond to that.

Chairman SHELBY. Go ahead.

Mr. MAURSTAD. Of course, right on the heels of the Congress signing the reauthorization and the President signing this, very early on in my tenure I recognized the importance of the appeal process based on discussions that I had with you, sir. And the 2004 hurricanes hit. And even though we did not have a formal appeals process in place, what occurred to me that was most important was that there be visibility that there was an appeal process, and that there be common knowledge that this appeal process exist. And we began last year during the 2004 hurricanes, our largest claim year ever, of making sure that that information was made available through disaster relief centers, disaster field offices, through the adjusters, by handing out that appeal process. We have closed 98 percent of the claims associated with the hurricanes of last year.

We continued this year to work on establishing that through the formal rulemaking process. I am committed to doing that. I am also looking at including the possibility of adding dispute resolution to the appeal process. I did not want to implement the formal appeal process and then amend it shortly thereafter.

So, I believe there are legitimate reasons as to why that formal appeal process has not been established yet, but I want to assure you and the Committee that we are implementing it in the spirit of which the Congress has asked us to.

Senator SARBANES. You do not assert that there is in place a formal appeals process, do you?

Mr. MAURSTAD. In the claims handbook that I——

Senator SARBANES. I am looking at this claim pamphlet, and let me get very direct to the question. Do you assert that these four steps to appealing your claim constitute a formal appeals process?

Mr. MAURSTAD. Sir, I do not want to argue with you. I believe that from my perspective, the four——

Senator SARBANES. I am just asking you a question.

Mr. MAURSTAD. Yes, sir. The formality of it would be that it be completed through the rulemaking process. This is an appeal process. We are looking at——

Senator SARBANES. This is not much of an appeals process. I mean you are told——

Mr. MAURSTAD. Well, Congress has indicated——

Senator SARBANES. Contact the adjuster, and then if you do not like the adjuster, contact the supervisor, and then you go back to your insurance agent. But where is the appeals process within FEMA where someone can say, "Well, you know, I was able to get it off of that level. They were not really giving me justice at that adjuster and supervisor level, and I was able at least to get into a process there, where some people in a sense from outside, maybe outside of that particular FEMA chain of command heard my claim, so I have some fairness in this appeals process."

Mr. MAURSTAD. The Congress at this point has indicated that the Insurance Administrator is responsible for settling those claims, and so the appeal process that goes to FEMA and through our system, once it has been determined by the policyholder the company or the adjuster has not met their needs, comes with the responsibility—to me with the responsibility that you have given through statute.

Senator SARBANES. What hearing process is there for the—I do not want to—I will close on it.

Chairman SHELBY. Go ahead.

Senator SARBANES. What hearing process is there for the complainant?

Mr. MAURSTAD. Right now the hearing process—I mean there is not a formal hearing process such as this. The process would be that the information is provided by the policyholder to the Administrator. The recommendation is provided to the Administrator on what the issues are, and if need be, then the Administrator makes a decision as to what the appropriate amount of that claim should be given the provisions of the standard flood insurance policy.

Senator SARBANES. I have used a lot of time, but that does not strike me as being——

Senator BUNNING. I will follow up, Paul.

Senator SARBANES. Okay. It does not strike me as being anywhere near satisfactory.

Chairman SHELBY. Senator Bunning, thank you for your indulgence.

Senator BUNNING. Thank you very much.

Mr. Maurstad, I am going to follow up some provisions that Senator Sarbanes talked about, and I want specific answers. I do not want all of your talking around the issue. Why haven't you implemented the provision of the law we passed 16 months ago? Why haven't FEMA implemented what was in the law?

Mr. MAURSTAD. From the first day that the law was signed we began the process. If you would like, I can provide the Committee with a status of each of the actions, where it is in the process, and provide that to you and to the Committee in response specifically as to where various aspects of the sections of the reauthorization are, but is the resources that we have available to us given the 2004 hurricane season——

Senator BUNNING. We did not give you that option.

Mr. MAURSTAD. Yes, sir.

Senator BUNNING. We passed the law and said it is up to you to get the regulations out for comment and passed, and you have not done it. I want to know who is responsible for the noncompliance. You? Michael Brown? Secretary Chertoff or someone else?

Mr. MAURSTAD. It would be me.

Senator BUNNING. It is you.

Mr. MAURSTAD. Yes, sir.

Senator BUNNING. When will you be putting out proposed regulations for comment?

Mr. MAURSTAD. On the appeals process?

Senator BUNNING. That is correct.

Mr. MAURSTAD. I hope to have that through——

Senator BUNNING. We did not do that in the law. We did not say, "Here is the new law. Here is the reauthorization." We said, "You are responsible for doing this." We did not give you a chance to say, "Oh, by the way, we are going to take 2 years to do this."

Mr. MAURSTAD. Yes, sir.

Senator BUNNING. You are responsible for getting it done, and there should be a time limit to get it done. Now we have had two major hurricanes, and now we do not have an official appeals process. In fact, we do not have one for Hurricane Isabel that hit Maryland. You are explaining all of these things, and they still do not get to the bottom line. Under an official, where they can say, "I had a fair hearing through FEMA, and I got either satisfied or not satisfied." No, you tell them, "Go to court." Do you know how expensive it is to go to court to get a claim filed and an appeal done? The people that have flood insurance cannot afford it.

When will FEMA be in compliance with our law?

Mr. MAURSTAD. As soon as I can make it happen. I understand your——

Senator BUNNING. When is that?

Mr. MAURSTAD. If I could give you a specific date, sir, I would.

Senator BUNNING. It is 16 months. How much more time do you need?

Mr. MAURSTAD. Your concerns have been——

Senator BUNNING. No. My concerns were when we passed the law, that you were going to get the job done, and so far you have not got the job done.

Mr. MAURSTAD. Well, I would say we have got the job done.

Senator BUNNING. You have not got the job done. Go into Maryland and talk to the people. Go into Louisiana, Mississippi, and Alabama and talk to the people. You have not got the job done.

How far along are you in updating the flood maps that have caused problems?

Mr. MAURSTAD. We are about halfway through the process, the 5-year plan that was adopted in the Map Modernization effort. We continue to work very closely with the States, the cooperating technical partners within those States to try to update and modernize those maps according to the schedule that has been provided.

Senator BUNNING. What about the maps of the area hit by Katrina and the updating before the storm? Where were you with that?

Mr. MAURSTAD. We were near providing those on a preliminary basis to the communities to start to adoption process. As a result of Katrina hitting, we suspended that activity so that we can use the information and the data that will be gathered by these storms to make sure those maps can be as pertinent as possible. So we are right in the midst of it.

Senator BUNNING. I am going to ask you the question again. When will FEMA be in compliance with the new law that we passed 16 months ago?

Mr. MAURSTAD. Sir, as I indicated before, I would love to be able to give you a specific date.

Senator BUNNING. Well, do you not think we have a right as the people who passed the law? The Congress got it through the Senate and it went through the House of Representatives. The President signed the law. Do you not think the agency that is in charge of enforcing and implementing the law should take it seriously?

Mr. MAURSTAD. We have taken it seriously and we are working——

Senator BUNNING. Sixteen months does not——

Mr. MAURSTAD. We are working as diligently as we can to enact——

Senator BUNNING. I do not accept that, sir. I am sorry, I do not accept 16 months delay as being a reasonable time to implement the law.

That is all.

Chairman SHELBY. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

And, Mr. Maurstad, I want to follow up some of the issues about the FEMA maps. Our maps are around 20 years out of date. As I understand the program, you provide a certain amount of money to the local agency to update the maps. A lot has changed in Rhode Island in 20 years, and I do not think we are atypical. How long is it going to take to get Rhode Island in again—you might not know the—but to get up to a point where the maps are current within a year or two of data?

Mr. MAURSTAD. I can get you the specific information that we are working with the State of Rhode Island on, on implementing the plan that we have jointly agreed to on when the maps would be updated.

Senator REED. Do you have an estimate?

Mr. MAURSTAD. It is a 5-year program now, and we are on target to have the first phase of that modernization done at the end of that 5-year program.

Senator REED. There is I think a digitization component, where all the data will be digitized. But will the maps be actually updated with taking into consideration all of the changing environmental conditions and coastal building?

Mr. MAURSTAD. Yes, sir. Again, that is what is agreed to between FEMA generally at the regional level, and the State level, in identifying which areas have had substantial changes where new studies need to be done as opposed to just taking the paper maps and digitizing them, which is appropriate in some circumstances, but certainly in a minority of circumstances.

Senator REED. My sense from talking to our State officials is that they get several hundred thousand dollars a year, and that is insufficient to do this mapping. Is there a problem here with appropriate funding levels so that it can be done in a timely way?

Mr. MAURSTAD. We continue to look at and take information from the individual States and the various stakeholders that were a part of the Map Modernization effort from 1995 to 2000, and look at that information now that we have been into the program for a couple of years, and are determining whether or not the current appropriation is going to be sufficient to completely get the job done to the extent that all of our stakeholders want to see it done. So we are using the first couple of years to assess. We now have actual data to determine what the costs are associated with mapping in different circumstances across different parts of the country, and are reviewing that.

Senator REED. When will you have a conclusion about how much money you need to get these maps updated, including not just digitization, but I would hope, particularly in sensitive areas, all the new information? When will you have that figure?

Mr. MAURSTAD. We are trying to identify those high-risk areas where new engineering studies, hydrology information needs to occur. We are in the process right now of working with DHS and OMB on the budget for next year, and we will be proposing something through that.

Senator REED. We have been told by the Association of State Floodplain Managers that even though in the Gulf Coast you do have new data that would require building outside of some zones, that you are going to use the old maps in terms of rebuilding, which raises the possibility people could go right back in and build houses in areas which under new maps would be prohibited; is that correct?

Mr. MAURSTAD. For Katrina?

Senator REED. The Gulf Coast today.

Mr. MAURSTAD. The Gulf Coast today. We have provided advisory elevation information to the Mississippi coast area, shared that with the local governments so that they can have that information on which to base their building permit circumstances. We are looking at doing the same thing in the New Orleans area. So we are in the process. We have provided the advisory information to Mississippi. We are in the process in Louisiana. And we will also be coming out in about 3 weeks with recovery mapping information that will be another tool that they will be able to use to make sure that they can make decisions and rebuild stronger.

Senator REED. Let me understand this. I will ask the question because I do not know the answer. It is advisory so that they do not have to follow this new data; is that correct?

Mr. MAURSTAD. It is advisory information, and as is the same with the normal flood maps, the local communities are responsible for adopting and enforcing ordinances to adopt floodmaps. If they were to pass an ordinance that would reflect this advisory data, then it would be required.

Senator REED. What is the consequence of this data with respect to the Flood Insurance Program?

Mr. MAURSTAD. If they use this data and build to the higher elevations that the data shows, then it will be a benefit to them when the new maps come out because they may be above what was required, and they would have lower flood insurance premiums as a result. So it is actually more of a benefit than it is a hammer, so to speak.

But the communities, when I have been down there, the information that we are getting from the field is the communities want this data because they want to rebuild at a higher level. They do not want to rebuild in the fashion in which they were just harmed.

Senator REED. How close are you to implementing the repetitive loss mitigation programs authorized last year?

Mr. MAURSTAD. The appropriation for that pilot program was included in the DHS budget that was just passed. So we have begun the process of developing the necessary rules, so we are hopeful during the next year that we will be able to get that program up and rolling.

Senator REED. Finally, the Corps of Engineers maintains maps and data with respect to inundation maps, storm scenarios. Are you trying to integrate your information? I think we have seen obviously in Katrina where the 100-year floodplain map did not actually describe the flooding, and the Corps of Engineers maps might not either, but they seem to be more sensitive to these major storm phenomena. Are you trying to get all that map on one page or at least make people aware of it? All the information, I should say.

Mr. MAURSTAD. Well, the inundation maps are used primarily for hurricane evacuation planning, and our maps are done to the 100-year flood level, and so they are developed for different purposes, but we certainly recognize that in some areas the 100-year flood levels reflected on the maps levels were too low. We certainly look at using, when appropriate, the maps that are provided by the Corps. So it is not like we do not consider them.

Senator REED. But, you know, the phenomenon—and I will conclude now because the Chairman has been very kind. But the situation is there are people down in the Gulf and people all over the country now who thought they were outside the flood zone, when, in fact, the Corps of Engineers maps would show in certain cases they were going to be flooded. And it seems to me that if we have that information at the Federal level, we would somehow make it available. Maybe it would not be tied to requiring insurance, but it would be made available.

Mr. MAURSTAD. People generally, as it has been relayed to me, look at the special flood hazard area, the highest-risk area, the 100-year flood area and they believe that if they are not—we do not tell them this, but they believe that if they are not in that mandatory purchase area, then they do not have to buy it.

The maps show varying levels of risk, and we communicate to people in our public awareness campaigns two things: One, a flood can happen to you; and, two, your homeowner's policy does not cover you for flood damage. And so it is a tool and it is important that the communities have accurate information and the policyholders have accurate information. But we need to dispel the perception that if you are not in the highest-risk area then you do not need to buy a flood insurance policy.

Senator REED. I agree, but I think the perception, frankly, is that and we have to do much more.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Senator Reed.

Mr. Maurstad, you head FEMA's Mitigation Division, correct?

Mr. MAURSTAD. Yes, sir.

Chairman SHELBY. How do we deal with the problem—I think it goes to the beginning here—of continuously bailing out people who build in these flood-prone areas, including Louisiana, Mississippi, Alabama, especially like Dolphin Island that you are familiar with and a lot of other areas?

Mr. MAURSTAD. Yes, sir.

Chairman SHELBY. How do we do this? Do we ever learn, I guess? Have we learned anything? Because if you are going to go back into these areas that are more than likely going to be flooded again, your beach is going to be destroyed or what land you have there, more than likely, a good chance. Isn't that some of the underlying question we have to grapple with here? You deal with mitigation.

Mr. MAURSTAD. Yes, sir, and, in fact, as far as rebuilding goes, if a home or a business is damaged at least 50 percent of its preflood market value, then it has to build back—the lowest elevation has to be built back to base flood elevation or higher. Seventy-five percent of the policies in the National Flood Insurance Program are at those higher levels. We have made a lot of progress over the last 37 years in reducing the number of properties that are not at base flood elevation or higher, that are not at less risk. We certainly need to continue, as I indicated in my remarks, to address the repetitive loss properties, and we do that both through the National Flood Insurance Program, but also through the Hazard Mitigation Grant Program, post-disaster, and also a significant number of the predisaster mitigation grant programs also target repetitive loss properties. So it certainly is an issue, and we want to continue to work with the Committee in dealing with it.

Chairman SHELBY. But that is a big public policy issue that faces us, is it not, up here?

Mr. MAURSTAD. Yes, sir. The whole issue of——

Chairman SHELBY. I guess the real question I am asking: Have we learned anything? Are we going to repeat mistakes of the past? Are we going to continue to bail out people who will continue to build in very hazardous areas?

Mr. MAURSTAD. Well, if they rebuild in those areas and they do not rebuild according to our regulations, they either will not have insurance or they will have very expensive insurance.

Chairman SHELBY. I appreciate, gentlemen, all of your participation here today, and maybe we are learning something. I hope so.

Thank you.

I am going to call up the second panel: Robert Hunter, as we all know, is Director of Insurance, Consumer Federation of America, no stranger to this Committee; Doug Elliott, President, Center on Federal Financial Institutions; Robert Hartwig, Senior Vice President and Chief Economist, Insurance Information Institute; Chad

Berginnis, Chief Financial Manager, Immediate Past Chair, State of Ohio, on behalf of the Association of State Floodplain Managers; and Professor Mark Browne, the Gerald D. Stephens CPCU Chair in Risk Management and Insurance, School of Business, University of Wisconsin.

Gentlemen, we appreciate your indulgence here today. I think this is all very important testimony for this record, and you can tell from the participation.

I want to tell you at the outset all of your testimony will be made part of this hearing record in its entirety. We are scheduled to have a vote on the Senate floor probably in about 20 minutes, 25 minutes, so if you would shorten your testimony as much as you can, make your chief points, we would appreciate it.

Mr. Hunter, we will start with you.

STATEMENT OF J. ROBERT HUNTER
DIRECTOR OF INSURANCE,
CONSUMER FEDERATION OF AMERICA

Mr. HUNTER. Mr. Chairman, I have served as Federal Insurance Administrator during the decade of the 1970's, and other jobs at the FIA, and I have been in this very room tarred and feathered.

[Laughter.]

I believe that the National Flood Insurance Program is an ingeniously designed program of carrots and sticks that by this time should have covered most of the flood-prone properties in the Nation, but, to my great disappointment, has not. And I have several serious questions to raise, Mr. Chairman, about how the program is going and some proposals which are really more in the form of questions but for your consideration.

Chairman SHELBY. Raise them quickly.

Mr. HUNTER. Yes. The first question, how do you move from subsidy to soundness? I think that you should consider moving to a 500-year requirement for mitigation and purchase. You should eliminate subsidies immediately on high-valued structures. Mid-valued structures should have their subsidy phased out over some intermediate term. Subsidies should be eliminated on homes with multiple floods in the past. I know you have moved in that direction. Low-valued structures should have their subsidies removed as the building is sold; maybe over three sales, the subsidy would be removed. Homes that would be in floodplains except for flood works such as levees that could fail should be required to buy coverage, at lower rates but should be required.

Rates should not be based solely on history. Modeling and more scientific methods should be used. You should consider giving private insurers skin in the game for the actuarially priced part of the business, the original excuse insurers use for not covering floods that they could not price in a way to avoid adverse selection. If you had a program where the insurers took 50 percent of the risk and the Federal Government took 50 percent of the risk, you could continue the purchase requirement. You could use modern technology to get actuarially priced business, and insurers can afford it. Even with 2005 events of Katrina and Rita, this will be their third highest profit year in history.

If insurers refuse to share the risk, then I think you should look at the excessive expense of write-your-own. We have already touched on that. You could go to the big contractor, but here is a very Republican idea. How about have FIA just establish the risk part of the rate, how much is for the risk, and let the private insurers compete for the expense part of the rate and by offering for lower money. Why not move in that direction?

Chairman SHELBY. Move the risk away from the taxpayers as much as we could?

Mr. HUNTER. Yes, not only move the risk away from the taxpayer, but also allow the insurance companies to compete on the expense portion of the rate by just establishing the pure premium of the rate.

The flood insurance policy should be redesigned to offer lower-cost policies for consumers choosing higher deductibles and other reduced coverage operation, but make it their choice. If they want to pay more, give them better coverage.

The second question, where is the market penetration? There should be an expansion of the coverage to the 500-year standard, as I mentioned. You have to find out why the percentages—every time there is a flood, 15 percent, 20 percent, 30 percent coverage. What is going on? I would find ways to make purchase required by all lenders, not just federally backed lenders, perhaps by offering incentives to the States to require purchase by State-regulated lenders. And I would require tracking to assure that the coverage is in place. I believe some of the bank institutions do require it. But I believe you need to make sure it is working.

Consideration should be given perhaps to requiring builders to buy a 5- or 10-year policy when they sell the structure in the first place. Then they would build it more wisely.

The third question, is mitigation working? GAO should be tasked with going out to the communities and seeing if the maps are really being enforced. When I walk along barrier islands, I doubt it. And I think it needs to be studied. In the meantime, you should require FIA to upgrade maps every 5 years, 3 years, something like that, and the maps should project the effects of development over the 3- to 5-year period, so that there is a freeboard to assure safety both of lives and property.

Fourth question, who will assure in the current situation proper wind versus water allocation? You must make sure that the write-your-own insurers do not hurt taxpayers by overstating flood damage in their claims adjustments as opposed to wind. You can see the conflict of interest. If it is flood damage, they do not pay anything. They just adjust it and send the bill to us as taxpayers. If it is wind damage, it affects their bottom line. There are serious questions about where wind stops and flood starts. Many lawsuits have already been filed, and there will be more. It is not a slam-dunk that these damages are not wind-related, and our research says that oftentimes the insurers are going to be wrong.

Question: Is FEMA challenging the write-your-own insurers as strongly as the attorneys for those without flood insurance are? And if not, why not? If insurers underpay wind, the taxpayers will suffer. But, equally bad, the next-door neighbor will suffer because if they can point to that and say, hey, look, they only paid 25 percent over there and FEMA does not push them to 50 where it belongs, that is going to hurt the next-door neighbor as well.

I think GAO—I am glad to hear they are there. You should make sure they do a really good audit, and it is vital that these kinds of questions be responded to, and this hearing is a very important first step, Mr. Chairman, and I congratulate you for it.

Chairman SHELBY. Thank you.

Mr. Elliott.

STATEMENT OF DOUGLAS J. ELLIOTT PRESIDENT, CENTER ON FEDERAL FINANCIAL INSTITUTIONS

Mr. ELLIOTT. Mr. Chairman, I will give you the 2-minute version.

First, our focus as an institution is on the Federal Government's lending and insurance activities. That is all we look at. Looking at the Federal Flood Insurance Program in that light, we see three major problems. One, we cannot persuade most of the target market to buy the policies.

Chairman SHELBY. Persuasion will not work, will it?

Mr. ELLIOTT. No, and I will talk about that. Unfortunately, I fear it is going to have to be more mandatory provisions. Second, the insurer does not have the financial resources to pay the claims that they expect to occur. And third, budget accounting is structurally misleading in this case.

The participation problem is worst because that hits real people directly. To answer Bob's question, there has been a fair amount of research about why people do not buy, and there seem to be two key reasons. One is there are rational economic reasons not to buy. It is one of the few insurance policies where if you do not buy, there is substantial money coming from other sources.

Chairman SHELBY. As opposed, say, to a regular homeowner's policy?

Mr. ELLIOTT. Exactly. If your house burns down, people will be sorry for you, but they probably will not give you much money; whereas, with flood insurance the NFIP calculates that the Federal Government provides an uninsured homeowner with a third of the value that they would have received from insurance without their ever having paid for the insurance. And that does not take account of State and local aid, charitable aid, and the fact that insurance premiums are not deductible but insurance losses are. So there are rational reasons not to buy.

In addition, research shows that most people irrationally do not want to buy insurance against catastrophic loss, anyway. I do not have time to go into that now.

The mandatory provisions, as you know, are leaky. A big reason they are leaky is because a third or more of people in these areas do not have mortgages, so you are not going to get them through provisions that tie to mortgages.

In terms of what can be done, I am certainly in favor of things that will increase voluntary participation, but it is unlikely to do much. In terms of mandatory provisions, there is a limit to what you can achieve with tightening current rules, partly because so many people do not have mortgages. A more radical solution would be to require that homeowner's insurance in these areas include flood insurance.

Very few people have no insurance at all on their house——

Chairman SHELBY. Based on the maps and the tendency to repeat ourselves.

Mr. ELLIOTT. Yes, exactly. You just say in flood-prone areas to have you have flood insurance if you buy a homeowner's policy. NFIP would still take the financial risk.

Chairman SHELBY. There would be a lot less risk to the taxpayer, wouldn't there?

Mr. ELLIOTT. Absolutely. There would be much less risk there.

Finally, in terms of the subsidy, we need much greater transparency than there has been. I have been able to calculate from figures provided by NFIP that they would need to charge about $1.3 billion more a year in order to cover the fully expected losses over time, including the occasional very bad catastrophe. That is basically a 40-percent subsidy on the whole program. It is concentrated, obviously, on those people in older houses, but it is very large in terms of the program.

I do not have a feeling about whether there should be that subsidy, but I know it should be obvious. Right now, there is a misconception that the program is self-supporting although we have designed it so it cannot be, because many of the homeowners are paying a fair price, while everybody else, the people with older homes, are getting heavily subsidized.

Chairman SHELBY. Basically the way it is set up today, it is set up to fail, is it?

Mr. ELLIOTT. Yes, it is set up to require the taxpayer to write a check every so often.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Hartwig.

STATEMENT OF ROBERT P. HARTWIG SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, INSURANCE INFORMATION INSTITUTE, NEW YORK, NEW YORK

Mr. HARTWIG. Thank you, Mr. Chairman. My name is Robert Hartwig. I am Chief Economist for the Insurance Information Institute, a property/casualty insurance trade association, and I, too, will cut to the chase. And I think many of my comments actually echo Mr. Elliott's.

Despite what we have heard today, since the NFIP has been in existence, in 1968, over the past 37 years much has actually been accomplished, and in many respects the NFIP does operate like a private insurance company combining concepts of insurance protection with hazard mitigation. So in exchange for federally backed flood insurance, communities must agree to adopt and enforce floodplain management ordinances to reduce future flood losses.

However, as we can see from the heavy borrowing NFIP must do this year, there are problems. And, in fact, the principal problem associated with the price of coverage today, it is not sufficient to account for the catastrophic events which we know will occur occasionally. And so I basically have two or three recommendations.

The first is the need to reflect the true cost of insuring against the peril of flood by adopting a policy of charging actuarially sound rates, thereby reducing the risk to taxpayers; and, second, an urgent need, as we have already heard several times, to dramatically increase participation rates in the Federal Flood Insurance Program in order to avoid a repeat of future human and economic tragedies on the scale of Katrina or worse.

I will concur with Mr. Elliott in terms of what factors are in play in the sense that—why people do not buy flood coverage. I believe that in some sense denial or a misperception of risk is ubiquitous and it is everywhere. We see it all across the country. For example, if people understand they live in a one-in-100-year floodplain, they typically interpret that as thinking they are not likely to see anything but one flood in the course of a century, when, in fact, in the course of a 30-year mortgage, you have a 26-percent chance of actually being flooded out.

Cost. Even given the option of buying coverage, no matter how modestly priced, most people will decline. Government aid also, large amounts of Government aid are routinely made available after disasters and will continue to be so, no matter what is done in the wake of Katrina. And so many people rationally reason that there is little point in buying flood coverage.

And then in a new twist we have legal action, Attorneys General in several States, in some Katrina-impacted areas, are now trying to sue homeowner's insurance companies to force them to pay flood losses that are clearly not covered under the terms of the contract, giving them false hope, and that is very tragic indeed.

And so to overcome these obstacles, which I believe generally are probably beyond the NFIP itself, I think that the most efficient way to substantially increase the NFIP's penetration rate among property owners is to expand mandatory participation through a lender-based system that ensures that the flood coverage is in force at all times for all mortgaged properties, and perhaps even for properties where the mortgage has already been paid off, within the 100-year floodplain and beyond. Lapse rates, from what I can tell, are 10 to 15 percent on an annual basis, and I will tell you that for private homeowner's insurance, which covers fire and wind and so on, approximately 96 percent of homes have it, and it is not significantly different whether or not there is a mortgage present on a property.

And it is also very important that these rates, which also allow the NFIP to accumulate a reserve, are placed in an NFIP lockbox, which would effectively help eliminate the risk to the U.S. taxpayers for the vast majority of disaster scenarios.

I think I will conclude there, sir, and thank you very much for the opportunity to appear today.

Chairman SHELBY. Thank you.

Mr. Berginnis.

STATEMENT OF CHAD BERGINNIS
CHIEF FINANCIAL MANAGER, IMMEDIATE PAST CHAIR, STATE OF OHIO

Mr. BERGINNIS. Thank you, Mr. Chairman. On behalf of the Association of State Floodplain Managers, its 21 chapters and 8,000 members representing State and local officials and other professionals engaged in all aspects of floodplain management, we thank you for the opportunity to offer our views on the program.

I first want to talk about the impact of the recent hurricanes. The anticipated claims do not indicate necessarily a failure of the NFIP. As Director Maurstad had mentioned, we are facing our first through catastrophic loss year, and now we need to look at future changes.

One set of these changes revolves around moving all policy premiums toward actuarial rating. As you are aware, a large percentage of flood insurance policies are pre-FIRM for structures built before the mapping and construction codes.

Chairman SHELBY. In other words, they are not based on current risk.

Mr. BERGINNIS. That is correct. And the original thought there was that we would reduce the older housing stock and replace it with flood-resistant stock, and that just has not happened as quickly. We believe there are at least two ways to reduce the pre-FIRM subsidy. First is through all available FEMA mitigation programs, including the reform act that was passed last year, and also reducing or eliminating the pre-FIRM subsidies for certain classes of structures, for instance, like vacation homes.

Mitigation is the best way, in our opinion, to reduce the susceptibility of flooding to pre-FIRM structures. It is a set of techniques that include elevating buildings, moving them out of harm's way, and from a mitigation standpoint, we would urge the Committee continue full funding and support for the 2004 reform act programs.

We also would urge FEMA to expedite the writing of the rules for implementation of the reform act provision. Since 83 percent of the repetitive loss properties are pre-FIRM, implementation of the reform act will reduce subsidized premiums by taking those structures out of harm's way. Similarly, we hope that Members will support FEMA's ongoing mitigation programs through the Robert T. Stafford Act.

Another set of recommendations revolves around the mandatory purchase requirement. I would like to take the opportunity to point out to the Committee that the first part of a comprehensive evaluation of the NFIP has been released as of March of this year through the American Institutes of Research. In that document are contained several excellent recommendations on the mandatory purchase provision.

The ASFPM, though, has several specific recommendations in our written testimony, and one such recommendation would be to examine alternatives to require lenders not currently subject to the mandatory purchase requirement to require their borrowers to obtain flood insurance. Some estimates put the number of new mortgages not subject to the mandatory purchase requirement as high as 40 percent, while for certain types of loans, such as those from manufactured homes, it might be as high as 70 percent.

It is also time that we consider changing the mandatory purchase requirement and extending it to areas beyond the 1-percent-chance floodplain. It is interesting to note that the actual act itself is not necessarily tied just to the 100-year floodplain. Although the 1-percent floodplain was identified along the Gulf Coast, areas subject to lower probability flooding from major storm surges was not shown on the flood maps. Similarly, areas behind protective levees and downstream of dams that would be inundated when a levee or dam fails are also not shown on flood maps.

Chairman SHELBY. So the maps are basically inadequate.

Mr. BERGINNIS. Correct. I would say probably inadequate as much as anything.

Chairman SHELBY. That is a mild word.

Mr. BERGINNIS. They just are not showing the true risk.

All of those areas have a common trait: They are areas of low probability flooding, yet they are areas of potential catastrophic damage. The ASFPM advocates the mapping of these areas nationwide, putting this information on the FEMA flood maps which are the most widely used tools for property owners and lenders to assess flood risk to an area, and institute a mandatory purchase insurance requirement for structures in those areas.

As I was watching television last night, for instance, in Massachusetts, property owners are being evacuated last night and today downstream of a dam that was anticipated to likely breach or overtop sometime today. So it does point out not only is this happening in the Gulf Coast, but also even in the Northeast.

There are also measures that can improve the effectiveness of current NFIP approaches. The NFIP is a quid pro quo program. It not only is an insurance program, but also requires new construction to be built to at least minimum standards of flood resistance. The first thing we need to do is get the flood maps in order. FEMA's map modernization program is underfunded and being haunted by program performance metrics that are resulting in maps that do not have the appropriate level of accuracy or detail.

There are thousands of miles of floodplains not yet mapped. Many flood hazard areas need detailed data, and many more need updated detailed information. We urge the Committee to support a map modernization program that will extend current funding levels for a total of 10 to 15 years, reflecting a total cost of $2 to $3 billion mapping program.

Finally, there are a few recommendations that we would also have in building standards. We would advocate the institution of a national freeboard standard—a freeboard meaning the lowest floor of a building would be elevated to one foot above the existing flood elevation. Nationally, not only would this result in an increased safety factor, but also it actually reduces flood insurance rates for the people complying with the code. It is now time that we change the minimum standard there.

We appreciate the opportunity to testify on this, and I would be happy to answer any questions. Thank you.

Chairman SHELBY. Thank you.

Professor Browne.

STATEMENT OF MARK J. BROWNE PROFESSOR, GERALD D. STEPHENS CPCU CHAIR RISK MANAGEMENT AND INSURANCE, SCHOOL OF BUSINESS, UNIVERSITY OF WISCONSIN—MADISON

Mr. BROWNE. Thank you, Senator Shelby. We appreciate the opportunity. You asked earlier what we have learned, and so I am going to take 30 seconds and tell you what I think we have learned and that will be my testimony.

First of all, people do not buy flood insurance, and they should. And, second, if we move to actuarially sound rates, without a mandate people are not going to purchase it. So we are shooting ourselves in the foot if we are trying to protect——

Chairman SHELBY. We are playing games with ourselves.

Mr. BROWNE. We are playing games, and we are going to hurt ourselves. We are trying to protect the Treasury funds of the United States, and I am afraid that if we do not have a mandate, we are not going to do that. I am also afraid that we need to think about earthquake, not just flood, and we need to think about man-made disasters, and we need to have an insurance program that addresses all of these, not just flood, or we are going to be in serious problems.

Earlier panelists have also indicated they support a mandate. They have suggested making it part of the homeowner's policy. They have also suggested making it a lender-based program. I am concerned about those. I think if you make it part of the homeowner's policy, then what you are going to do is discourage people from purchasing homeowner's insurance. What I would prefer to see is a mandate that is based on a property tax, a national property tax to cover risk. It could be adjusted for different areas with different rates.

Chairman SHELBY. Would that be difficult to pass, a national property tax?

Mr. BROWNE. I am sure it would be, but you know more than I do. I am an economist here, Senator.

[Laughter.]

I think it would work in terms of economics, and if you think it is a worthwhile idea, I guess you would need to build the consensus for it.

[Laughter.]

Chairman SHELBY. Well, I hope you could build consensus for it.

Mr. BROWNE. You would have my vote.

Chairman SHELBY. Well, I would vote against that.

[Laughter.]

Mr. BROWNE. Thank you.

Chairman SHELBY. I do have a few questions.

Mr. Elliott, to you first. You suggest in your testimony that tougher mandatory provisions are likely needed to increase program participation. Do you have specific suggestions as to which program provisions should be made tougher? In other words, are the current civil money penalties of $385 maximum per violation sufficient to ensure lender compliance?

Mr. ELLIOTT. You know, the American Institute of Research report was mentioned earlier, which is very good. The thing that struck me reading through that is the problem does not seem to be so much getting it set up in the first place. It is that these mortgages are sold all the time, and it seems that a central authority whose job was to make sure that mortgages were followed along would probably do more good than changing the money penalties.

Chairman SHELBY. If you did increase the pool—in other words, first you have to do the mapping and you have to do it right. That is very important. And if it were mandatory, as a lot of you suggest, that people that are in these high-risk areas buy this insurance, flood insurance, and other catastrophic insurance, the more people in the pool, the premium goes down, does it not? You are the economist.

Mr. BROWNE. The problem that you have with these types of situations is what is known as simultaneous destruction. You have the potential for wiping out the pool, and that is one reason that economists feel this might not be a risk that is transferred to the private market. So the risks are correlated.

Chairman SHELBY. So you want to transfer it all to the taxpayer?

Mr. BROWNE. No. What I really think is important is for the individuals at risk, those who are deriving the benefit from living in an area, to bear the cost. I think that is fundamentally important.

Chairman SHELBY. That is true of most other things, is it not?

Mr. BROWNE. Yes, it is.

Chairman SHELBY. Isn't that what insurance is based on, in a sense?

Mr. BROWNE. Actuarially fair pricing is what is mandated by private markets.

Chairman SHELBY. Sure.

Mr. Hartwig, I believe you also suggested expanding mandatory participation. Do you have some suggestions or one specific suggestion here?

Mr. HARTWIG. Yes, basically going well beyond the 100-year floodplain. I think the interpretation among the average person out there is that if you live in a one-in-100-year floodplain you are not going to even live long enough to actually see a flood. But as I mentioned in my testimony, you actually have a 26-percent chance of seeing a flood in the course of a 30-year mortgage. And so when you go beyond that one-in-100-year floodplain, the risk is not one in 250 years in the course of the mortgage either. The risk is much, much higher than the average person perceives, and hence that gets into the mandatory requirement.

Chairman SHELBY. It is just common sense that we all know that in these low-lying areas, Louisiana particularly, but parts of Texas, even some areas in my State, with the hurricane season seeming to pick up more and more, there is more of a likelihood that there is going to be more hurricanes, more damage, than there are going to be in, say, Wyoming or Utah and places like that. That is common sense, is it not?

Mr. HARTWIG. Yes, it is. But I would argue that the NFIP could not have gotten into the financial mess that it is in today by itself. It had a lot of help. And there are literally hundreds of thousands of structures today that would have never been built were it not for the implicit guarantees of a myriad of Government-run insurance enterprises, of which the NFIP is one. And, in fact, there are such plans in about 30 States, most of which operate at deficits, and collectively, along with the NFIP, they write 6.6 million policies with a face value of $1.2 trillion. And when they suffer losses, most of those cases, they are assessed back on people who live nowhere near the water, or in the case of the NFIP, it goes to the taxpayer.

Chairman SHELBY. Professor Browne, the pricing of insurance premiums. In your research on the demand for flood insurance, you characterized the demand for policies—and these are your words—

as "relatively insensitive to changes in price." If prices were increased as a result of reducing subsidies, what impact do you think this would have on participation? Do you believe this impact would differ across incomes?

Mr. BROWNE. Yes, I do. I did not test if it would change across incomes. And when I was saying that it was relatively inelastic, it was still elastic. It was just in comparison to some other goods and other types of insurance products. So we should expect that if the price increases, there will be decreases in the amount of insurance purchased.

Chairman SHELBY. Mr. Berginnis, Mr. Hunter earlier has suggested using a 500-year floodplain mandatory purchase standard instead of the current 100-year standard. How feasible do you think this would be to implement? Are 500-year floodplains as commonly mapped as the 100-year floodplains? And what would it take as far as mapping to get there?

Mr. BERGINNIS. Well, it would certainly take an increased focus from a mapping standpoint, but in terms of implementation, I think what—and, again, some of the other panelists have talked about it. Property owners seem to get very wrapped around this concept of I am either on one side of the hazard line or on the other. And I think that it might be good for us as we explore some of these larger mapping areas, not only is it feasible but we also change the terminology, just say this is a high-risk flood hazard area, this is a catastrophic risk flood hazard area, and get away from this 100-year or 500-year, because I have had homeowners call me up and say, well, I am 76 years old, and I still have a good 24 years left before I am going to experience a 100-year flood.

Folks really have a deep misconception of that. I do not think it would be difficult at all, quite frankly, to extend the mandatory purchase to a 500——

Chairman SHELBY. I think a lot of those people that say they have not experienced a flood, they need to go to the Gulf Coast and look around right now.

Mr. BERGINNIS. Yes, sir.

Chairman SHELBY. I thank all of you. We have a vote that I have to make on the Senate floor. Thank you very much for your impact here.

The hearing is adjourned.

[Whereupon, at 12:21 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF DAVID I. MAURSTAD

ACTING DIRECTOR AND FEDERAL INSURANCE ADMINISTRATOR
MITIGATION DIVISION, FEDERAL EMERGENCY MANAGEMENT AGENCY
EMERGENCY PREPAREDNESS AND RESPONSE DIRECTORATE
U.S. DEPARTMENT OF HOMELAND SECURITY

OCTOBER 18, 2005

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I am David Maurstad, Acting 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), particularly after the devastating effects of Hurricanes Katrina and Rita.

FEMA's Mitigation Division manages the NFIP—the cornerstone of the Nation's strategy to prepare communities for flood events. When I accepted the position of Acting Director of Mitigation, the NFIP became one of my most important responsibilities and a top priority. During my tenure, I have used my 25 years of experience in the insurance industry to help guide the successful implementation of this program.

This year's hurricane season represents a significant challenge for the NFIP. Hurricane Katrina was a monumental flooding event that was further exacerbated by the impact of Hurricane Rita. The magnitude and severity of flood losses related to these storms are unprecedented in the history of the NFIP. The challenges these storms have presented to the Mitigation Division—in terms of flood insurance claims handling, floodplain management, and mitigation planning and grants management—have never been encountered, on this scale, before.

Let me provide a context for what the NFIP, and the Nation, is facing. Since the NFIP's inception in 1968, $15 billion has been paid out to cover more than 1.3 billion losses. In 2001, Tropical Storm Allison resulted in the NFIP's first billion-dollar storm with over 30,291 claims received totaling $1.1 billion. Just last year, the 2004 hurricane season resulted in over 75,022 claims totaling close to $2 billion paid out in NFIP coverage.

We estimate that Hurricanes Katrina and Rita will result in flood insurance claims that significantly exceed the highest number of claims filed from any single event in the NFIP's history, and well more than triple the total number of claims filed in 2004. The Katrina and Rita-related NFIP claims could exceed $22 billion, far surpassing claims paid in the entire history of the NFIP.

These claims from those whose homes and businesses have been damaged or destroyed by Hurricane Katrina are not a new obligation—they are the result of a legal promise we made to these homeowners and business owners when Congress passed the National Flood Insurance Act of 1968 and subsequent revisions. Homeowners and business owners agreed to pay premiums, communities agreed to adopt building codes to mitigate flood dangers, and the Federal Government agreed to provide insurance coverage to policyholders after a disaster. Every single one of these claims represents someone who has taken the responsible course of action by purchasing flood insurance and paying premiums to the Government. We not only have a legal obligation to honor our commitments, but we also have a moral obligation to provide the coverage we have promised to provide.

Since the tragic events of the past 6 weeks, I have traveled to the Gulf Coast to meet and work closely with the Insurance Commissioners from the affected areas. After seeing the devastation first hand and listening to State and local government representatives, insurance industry representatives, and flood victims, we have developed a post-disaster mitigation strategy that will carry us forward in the days, months, and years ahead. Now, more than ever, we must build on these already strong partnerships and remain engaged in developing and implementing innovative approaches and solutions to meet the many challenges we will face as we help the Gulf Coast rebuild stronger, safer, and smarter.

Today, I will focus on the National Flood Insurance Program's financial status, and highlight several aspects of our post-disaster mitigation strategy. This strategy aggressively provides critical flood insurance information to State and local officials, adjusters, home and business owners, and policyholders in the affected areas so that they may rebuild a stronger, less vulnerable Gulf Coast.

NFIP Financial Status and Related Issues

Congress authorized NFIP in 1968 following a series of hurricanes in the mid-1950's and 1960's. At that time, affordable flood insurance was not generally available from the private insurance industry. The concept was that the Federal Government would make flood insurance available to the people if local governments would adopt and enforce measures to make future construction safer from flooding.

Today, more than 20,100 communities in all 50 States and U.S. Territories voluntarily participate in the NFIP, representing about 95 percent of all properties in the Nation's Special Flood Hazard Areas. The NFIP provides these communities with maps that identify flood risks and help local government decisionmakers determine how flood-prone areas are used and how buildings in these areas should be constructed. These maps, that we are in the process of modernizing and making more accessible to homeowners, are also used to determine flood insurance rates.

As previously stated, $15 billion have been paid out since the NFIP's inception to cover more than 1.3 billion losses. Many of these claims occurred as a result of smaller flood events where no other Federal disaster assistance was available. Yet these property owners endured as much of an individual loss as those in larger events. In this regard, studies have indicated that insurance is the most efficient and equitable method of providing disaster assistance.[1] Since 1986, the NFIP has been financially self-supporting for the average historical loss year. During periods of high losses, consistent with the law, the NFIP has borrowed from the U.S. Treasury. These loans have been repaid, with interest, from policyholder premiums and related fees, and at no cost to the Nation's taxpayers. Last year's claims activity represented a significant loss year for the NFIP, and the program exercised its borrowing authority in the amount of $225 million. This was only the fourth time since 1990 that the Program was in a borrowing position.

The NFIP currently insures in excess of $800 billion in assets. This covers more than 4.7 million policies for homes, businesses, and other nonresidential property owners. Each year the NFIP collects approximately $2 billion in premiums and fees.

Hurricane Katrina was a catastrophic event. More than 200,000 flood insurance claims are likely to be filed.

The NFIP provides insurance at actuarial (risk-based) rates, including consideration for catastrophic losses, for newer construction, with approximately 76 percent of policyholders paying actuarial rates. For structures built prior to the mapping and imposition of NFIP floodplain management requirements less than full-risk rates are charged because flood risks were not fully known when these structures were built. Approximately 24 percent of policyholders pay less than full-risk rates. It is important to note the NFIP has never been capitalized.

Our authority to borrow from the Treasury is an essential part of the NFIP's financing for heavy loss years. Because of Hurricane Katrina, on September, 20, 2005, the President signed into law H.R. 3669, which increased the NFIP's borrowing authority by $2 billion.[2] Current flood insurance claims projections for Hurricanes Katrina and Rita indicate additional borrowing authority will be necessary. The total payout for Katrina alone may be as much as 10 times the highest annual loss, and 20 times the program's average historical annual losses.

Streamlining the NFIP Claims Process

It is my job to ensure that, consistent with statute and regulations, flood insurance claims are handled fairly, equitably and in a timely manner. Given the catastrophic impact these events have had in the Gulf, a critical first step was to implement a simplified and streamlined claims process to help policyholders settle their claims quickly.

Utilizing state-of-the-art aerial imagery, up-to-date water-depth data, and information from extensive underwriting files, the Write-Your-Own (WYO) companies are rapidly identifying insured properties that have been washed off their foundations, have had standing water in them for an extended period, or have only pilings or concrete slabs remaining. Under such circumstances, adjusters are waiving proof of loss requirements and fast-tracking claims up to the maximum insured value.

Using these streamlining methods, we expect to substantially reduce our normal adjustment times from what one would normally see under such extreme circumstances. To ensure *all* claims are handled quickly and fairly, we are closely monitoring the performance and procedures of the WYO carriers that are using these Katrina-specific processes.

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.* With the Chairman's permission, I would like to submit copies of these documents for the record.

[1] See GAO Report, PAD–80–39.
[2] See Pub. L. 109–65.

These easy-to-understand documents have been available in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers—as well as in Town Meetings—since September 1, 2005. I have personally handed these materials to State Insurance Commissioners in Alabama, Mississippi, and Louisiana, and we have distributed an informational CD containing these documents and other ready-to-print materials to field offices, State and local government offices, and the media.

Recognizing that a significant number of policyholders were displaced, FEMA has implemented four systems to reach policyholders early in the claims process. These systems have been particularly useful to those who are cut off from their usual sources of information and communication.

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 system will now become standard operating procedure in future flooding events. It has enabled the WYO Companies to reach out to their NFIP policyholders and help them immediately when they needed it most.

A help line staffed with insurance specialists has been established in our Jackson, Mississippi Joint Field Office to provide telephone support to all Disaster Recovery Centers (DRC's). These insurance specialists provide general information on the NFIP and can assist policyholders with their flood insurance policy questions. They can also transfer callers to their specific insurance companies, if necessary.

Additionally, we have set up a General Insurance Center, which can be reached by calling 1–800–427–4661, to provide policyholders with service access from anywhere, since many have been relocated to areas where DRC's are not available. This center will answer the insureds' claims and coverage questions, as well as guide them through avenues of recourse if they dispute their claims estimates.

To ensure that our policyholders are provided with maximum access to our services, we have partnered with the Insurance Information Institute's Disaster Insurance Hotline. By calling 1–800–942–4242, callers will be given flood insurance information as well as their specific insurance company's direct phone number.

These systems reflect FEMA's effort to reach out to policyholders as early in the claims process as possible and recognize the sooner claims are settled, the sooner people can start rebuilding their lives and communities. For comprehensive information on the NFIP and flood insurance, policyholders can access our FloodSmart website at *www.floodsmart.gov.*

NFIP and Mitigation Reconstruction/Rebuilding Support

As the focus shifts from disaster response to disaster recovery, areas impacted by Hurricanes Katrina and Rita will begin to review and consider the opportunities for rebuilding a less vulnerable Gulf Coast. However, the overwhelming desire to rebuild immediately must be balanced with the need to rebuild wisely.

Effective planning—based on updated risk assessments, sound floodplain management, solid mitigation principles, and applicable environmental management and historic preservation considerations—will be a critical first step in the Gulf's recovery process. We are teaming up with our Federal, State, and local partners to (1) provide communities with the resources they need to get the job done right; (2) provide communities with incentives to rebuild stronger; (3) work with the affected States and communities to mitigate properties that have repeatedly flooded; and (4) integrate NFIP code compliance assistance into our mitigation grant processes.

Providing Resources

FEMA is committed to working with its partners to provide communities with state-of-the-art tools and resources they need to make informed planning and rebuilding decisions. We are working closely with our Federal partners, such as the Army Corps of Engineers and the National Oceanographic and Atmospheric Administration, to gather and use the best available data for developing advisory information and NFIP recovery maps. We are also working with the Environmental Protection Agency and the Department of Health and Human Services on cleanup issues related to reconstruction. Finally, we are engaged with the Heritage Emergency Task Force to ensure that mitigation strategies in the Gulf region adequately consider historic preservation and related matters.

Our Mitigation Assessment Teams are in the field gathering data on the performance of buildings and infrastructure. These teams are working closely with State and local officials to recommend improved building design and construction techniques, advocate new building codes and enforcement measures, and suggest mitigation activities that will improve community-wide disaster resistance.

Overall, FEMA, along with its Federal, State, community, and private sector partners, is making sure that technology, information, and resources are expeditiously provided to the Gulf Coast and properly used during the rebuilding process.

Rebuilding Stronger through Higher Standards

A significant part of FEMA's Gulf Coast Mitigation Strategy is development of measures to encourage communities to rebuild stronger. Our Community Rating System (CRS) will play a major role in this effort. CRS provides insurance discount incentives to communities that are actively reducing their flood risk by implementing comprehensive floodplain management criteria that go beyond the NFIP's minimum requirements.

CRS communities that continually reduce their flood risks receive flood insurance premium discounts representative of the degree of risk reduction achieved. Over 66 percent of the NFIP's policy base reside in CRS communities, and 3.1 million NFIP policyholders residing in these communities receive over $150 million in discounts annually.

There are currently 68 CRS communities in the Gulf Coast area. Our goal is to increase that number as our Gulf Coast area participating communities become engaged in a process that focuses on rebuilding stronger and smarter.

Addressing Repetitive Loss through Mitigation

FEMA also will address the issue of repetitive loss properties (properties with two or more $1,000 flood insurance claims within a 10-year period) as Gulf Coast reconstruction gets underway. The Alabama and Mississippi areas affected by Katrina have about 2,200 and 2,500 repetitive loss properties respectively (as of October 5, 2005). The Louisiana Parishes affected by Katrina contain nearly 20,000 repetitive loss properties. FEMA will work with the States, local governments, and CRS communities to mitigate these properties through elevation, relocation, flood proofing, localized flood control, and acquisition/demolition.

Increased Cost of Compliance and Mitigation

FEMA also is coordinating with States, local governments, and CRS communities to integrate Increased Cost of Compliance funds—money for NFIP policyholders to bring their structures up to existing flood-related building codes—into all relevant mitigation efforts. Finally, our Federal, State, and local government partnership will ensure that all Gulf-area mitigation proposals are based on sound risk assessments and approved mitigation plans.

Sound floodplain management planning and regulations save this country an estimated $1.1 billion in prevented flood damages annually, and structures built to NFIP criteria experience 80 percent less damage than structures not built to such standards. FEMA is determined to help Gulf Coast communities make reconstruction decisions that are based not only on sound floodplain management, risk assessment, and mitigation planning principles, but also on higher protection standards. Creating stronger and safer communities reduces loss of life and property, enables individuals and localities to rapidly recover from future events, and lessens the financial impact on State, Tribal, and local governments, as well as the U.S. Treasury.

Conclusion

In the wake of Hurricanes Katrina and Rita, FEMA is committed to supporting the Gulf Coast's recovery. In the near-term, this will require ensuring adequate funding to fulfill our commitment to our NFIP policyholders. For the longer-term, it will require working closely with the Gulf Coast's affected States, local governments, communities, and private-sector entities to support a reconstruction effort that results in safer places to live, work, and do business.

I would be pleased to answer any questions Committee Members may have.

United States Government Accountability Office

GAO

Testimony Before the Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate

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FEDERAL EMERGENCY MANAGEMENT AGENCY

Challenges Facing the National Flood Insurance Program

Statement of William O. Jenkins, Jr., Director, Homeland Security and Justice Issues

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Highlights

Highlights of GAO-06-174T, a testimony before the Chairman, Banking, Housing, and Urban Affairs Committee, U.S. Senate

Why GAO Did This Study

The disastrous hurricanes that have struck the Gulf Coast and Eastern seaboard in recent years—including Katrina, Rita, Ivan, and Isabel—have focused attention on federal flood management efforts. The National Flood Insurance Program (NFIP), established in 1968, provides property owners with some insurance coverage for flood damage. The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security is responsible for managing the NFIP.

This testimony offers information from past GAO work on (1) the financial structure of the NFIP, (2) why the NFIP insures properties for repetitive flood losses and the impact on NFIP resources; and (3) compliance with requirements for mandatory purchase of NFIP policies. The testimony also discusses recommendations from a report GAO is issuing today on FEMA's oversight and management of the NFIP.

What GAO Recommends

In the report released today, GAO is recommending, among other things, that FEMA and its partners use a statistically valid approach to sample NFIP insurance claim files for quality assurance purposes, and that DHS and FEMA develop and document plans for implementing requirements of the Flood Insurance Reform Act of 2004, which reauthorized the NFIP. FEMA disagreed with those recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-06-174T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William O. Jenkins, Jr., at (202) 512-8777 or jenkinswo@gao.gov.

October 2005

FEDERAL EMERGENCY MANAGEMENT AGENCY

Challenges Facing the National Flood Insurance Program

What GAO Found

As GAO has reported, the NFIP, by design, is not actuarially sound. The program does not collect sufficient premium income to build reserves to meet long-term future expected flood losses, in part because Congress authorized subsidized insurance rates to be made available for some properties. FEMA has generally been successful in keeping the NFIP on a sound financial footing, but the catastrophic flooding events of 2004 (involving four separate hurricanes) required FEMA, as of August 2005, to borrow $300 million from the U.S. Treasury to help pay an estimated $1.8 billion on flood insurance claims. Following Hurricane Katrina in August 2005, legislation was enacted to increase FEMA's borrowing authority from $1.5 billion to $3.4 billion through fiscal year 2008.

Properties that suffer repeated flooding but generally pay subsidized flood insurance rates—so-called repetitive-loss properties—constitute a significant drain on NFIP resources. These properties account for roughly 1 percent of properties insured under the NFIP, but account for 25 percent to 30 percent of all claim losses. The Flood Insurance Reform Act of 2004 established a pilot program requiring owners of repetitive-loss properties to elevate, relocate, or demolish houses, with NFIP bearing some of those costs. Future studies of the NFIP should analyze the progress made to reduce the inventory of subsidized repetitive-loss properties, and determine whether additional regulatory or congressional action is needed.

In 1973 and again in 1994, legislation was enacted requiring the mandatory purchase of NFIP policies by some property owners in high-risk areas. In June 2002, GAO reported that the extent to which lenders required to do so enforced mandatory purchase requirements was unknown. While FEMA officials believed that many lenders often were noncompliant, neither side could substantiate its claims regarding compliance.

FEMA did not use a statistically valid method for sampling files to be reviewed in its monitoring and oversight activities. As a result, FEMA cannot project the results of these reviews to determine the overall accuracy of claims settled for specific flood events or assess the overall performance of insurance companies and their adjusters in fulfilling responsibilities for the NFIP—actions necessary for FEMA to have reasonable assurance that program objectives are being achieved.

FEMA has not yet fully implemented provisions of the Flood Insurance Reform Act of 2004 requiring the agency to develop new materials to explain coverage and the claims process to policyholders when they purchase and renew policies, establish an appeals process for claimants, and provide insurance agent education and training requirements. The statutory deadline for implementing these changes was December 30, 2004, and as of September 2005 FEMA had not developed documented plans with milestones for meeting the provisions of the act.

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to participate in today's hearing on the future of the National Flood Insurance Program (NFIP) to discuss issues related to the future financial stability of the NFIP and recommendations we have made for improvements to the management and oversight of the program. The NFIP combines property insurance for flood victims, mapping to identify the boundaries of the areas at highest risk of flooding, and incentives for communities to adopt and enforce floodplain management regulations and building standards to reduce future flood damage. The effective integration of all three of these elements is needed for the NFIP to achieve its goals of:

- providing property flood insurance coverage for a high proportion of property owners who would benefit from such coverage;
- through this insurance coverage reducing taxpayer-funded disaster assistance when flooding strikes, and
- reducing flood damage through flood plain management and the enforcement of building standards (such as elevating structures).

The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security (DHS) is responsible for the oversight and management of the program.[1] Under the program, the federal government assumes the liability for the insurance coverage and sets rates and coverage limitations, among other responsibilities.

Floods are the most common and destructive natural disaster in the United States. According to NFIP statistics, 90 percent of all natural disasters in the United States involve flooding. However, flooding is generally excluded from homeowner policies that typically cover damage from other losses, such as wind, fire, and theft. Because of the catastrophic nature of flooding and the inability to adequately predict

[1] In March 2003, FEMA and its approximately 2,500 staff became part of the Department of Homeland Security (DHS). Most of FEMA—including its Mitigation Division, which is responsible for administering the NFIP—is now part of the department's Emergency Preparedness and Response Directorate. However, FEMA retained its name and individual identity within the department. Under a reorganization plan proposed by the current Secretary of DHS, the Emergency Preparedness and Response Directorate would be abolished, and FEMA would report directly to the Undersecretary and Secretary of DHS.

flood risks, private insurance companies have largely been unwilling to underwrite and bear the risk of flood insurance.

Congress established the NFIP pursuant to the National Flood Insurance Act of 1968[2] to provide policyholders with some insurance coverage for flood damage, as an alternative to disaster assistance, and to try to reduce the escalating costs of repairing flood damage. In creating the NFIP, Congress found that a flood insurance program with "large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated."[3] In keeping with this purpose, FEMA has contractual agreements with 95 private insurance company partners to sell policies and adjust and process claims.

As of August 2005, the NFIP was estimated to have approximately 4.6 million policyholders in about 20,000 communities. Since its inception, the program has paid about $14.6 billion in insurance claims, primarily from policyholder premiums that otherwise would have been paid through taxpayer-funded disaster relief or borne by home and business owners themselves. According to FEMA, every $3 in flood insurance claims payments saves about $1 in disaster assistance payments, and the combination of flood plain management and mitigation efforts save about $1 billion in flood damage each year.

The unprecedented damage wrought by Hurricanes Katrina and Rita are also likely to result in unprecedented claims on the NFIP. GAO is beginning a body of work on the preparation for, response to, and recovery from Hurricanes Katrina and Rita. As GAO moves forward with this work, we will continue to work with this and other congressional committees and the accountability community—federal inspector generals, state and city auditors—regarding the scope of our future work on emergency management issues, including the NFIP. Our goal is to apply our resources and expertise to address long-term concerns, such as those we are discussing today, and to avoid duplicating the work of others. Currently, we have teams in the Gulf Coast states collecting data and observations from hurricane victims and federal, state, local, and private

[2]The National Flood Insurance Act of 1968, as amended, is codified at 42 U.S.C. 4001 to 4129.

[3]42 U.S.C. 4001(b)(2).

participants in the preparation for, response to, and recovery from these devastating hurricanes, including the flooding they caused.

Past experience can provide context for considering future policy options. In this spirit, my testimony today is based on a body of work that GAO has done over the past several years before the nation began the struggle to respond to the devastating effects of Hurricanes Katrina and Rita in our Gulf Coast states. This prior work has addressed the issues of the program's structure and financing, repetitive loss properties, mandatory and voluntary purchase of flood insurance, and revising and improving the nation's flood maps. Together they provide information useful in assessing efforts over the NFIP's history to enhance the program's financial stability and effectiveness. Today, we are also releasing a report on FEMA's management and oversight of the flood insurance program that includes several recommendations for improvement.[4] This report was mandated by the Flood Insurance Reform Act of 2004.[5] It includes recommendations

on two pre-Hurricane Katrina flood-insurance related issues that pose a challenge for FEMA. These are (1) improving FEMA's management and oversight of the NFIP and (2) FEMA's implementation of provisions of the Flood Insurance Reform Act of 2004 to provide policyholders a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that flood insurance agents meet minimum NFIP education and training requirements.

The report we are releasing today is based on interviews with FEMA officials, documentation of its monitoring and oversight processes, and our field observations of FEMA's monitoring and oversight activities. In addition, we analyzed the National Flood Insurance Act of 1968, as amended, its legislative history, and FEMA's implementing regulations, and we examined documentation and interviewed officials about FEMA's efforts to comply with provisions of the 2004 Flood Insurance Reform Act. We did our work from December 2004 to August 2005 in accordance with generally accepted government auditing standards.

[4]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).

[5]Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, 118 Stat. 712, 727 (2004).

Major Program Issues—A Summary

A key characteristic of the NFIP is the extent to which FEMA must rely on others to achieve the program's goals. FEMA's role is principally one of establishing policies and standards that others generally implement on a day-to-day basis and providing financial and management oversight of those who carry out those day-to-day responsibilities. These responsibilities include ensuring that property owners who are required to purchase flood insurance do so, enforcing flood plain management and building regulations, selling and servicing flood insurance policies, and updating and maintaining the nation's flood maps. In our prior work, we have identified several major challenges facing the NFIP:

- **Reducing losses to the program resulting from policy subsidies and repetitive loss properties.**[6] The program is not actuarially sound because of the number of policies in force that are subsidized—about 29 percent at the time of our 2003 report. As a result of these subsidies, some policyholders pay premiums that represent about 35-40 percent of the true risk premium. Moreover, at the time of our 2004 report, there were about 49,000 repetitive loss properties—those with two or more losses of $1,000 or more in a 10-year period—representing about 1 percent of the 4.4 million buildings insured under the program. From 1978 until March 2004, these repetitive loss properties represented about $4.6 billion in claims payments.
- **Increasing property owner participation in the program**. As little as half of eligible properties may participate in the flood insurance program. Moreover, the extent of noncompliance with the mandatory purchase requirement by affected property owners is unknown.
- **Developing accurate, digital flood maps.**[7] In our report on the NFIP's flood map modernization program, we discussed the multiple uses and benefits of accurate, digitized flood plain maps. However, the NFIP faces a major challenge in working with its contractor and state and local partners of varying technical capabilities and resources to produce accurate, digital flood maps. In developing those maps, we recommended that FEMA develop and implement data standards that will enable FEMA, its

[6] GAO, *Flood Insurance: Challenges Facing the National Flood Insurance Program*,GAO-03-606T (Washington, D.C.: April 1, 2003); *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*,GAO-04-401T (Washington, D.C.: March 25, 2004).

[7] GAO, *Flood Map Modernization: Program Strategy Shows Promise, but Challenges Remain*, GAO-04-417 (Washington, D.C.: March 31, 2004).

contractor, and its state and local partners to identify and use consistent data collection and analysis method for developing maps for communities with similar flood risk.

- **Providing effective oversight of flood insurance operations.** In the report we are releasing today, we note that FEMA faces a challenge in providing effective oversight of the 95 insurance companies and thousands of insurance agents and claims adjusters who are primarily responsible for the day-to-day process of selling and servicing flood insurance policies.

The NFIP Pays Expenses and Claims with Premiums, but Its Financial Structure Is Not Designed to be Actuarially Sound

To the extent possible, the NFIP is designed to pay operating expenses and flood insurance claims with premiums collected on flood insurance policies rather than with tax dollars. However, as we have reported, the program, by design, is not actuarially sound because Congress authorized subsidized insurance rates to be made available for policies covering some properties to encourage communities to join the program. As a result, the program does not collect sufficient premium income to build reserves to meet the long-term future expected flood losses.[8] FEMA has statutory authority to borrow funds from the Treasury to keep the NFIP solvent.[9]

Until the 2004 hurricane season, FEMA had been generally successful in keeping the NFIP on sound financial footing. It had exercised its authority to borrow from the Treasury three times in the last decade when losses were heavy and repaid all funds with interest. As of August 2005, the program had borrowed $300 million to cover an estimated $1.8 billion in claims from the major disasters of 2004, including hurricanes Charley, Frances, Ivan, and Jean, which hit Florida and other East and Gulf Coast states. The large number of claims arising from Hurricanes Katrina and Rita will require FEMA to borrow heavily from the Treasury, because the NFIP does not have the financial reserves necessary to offset heavy losses in the short-term. Following Hurricane Katrina in August 2005, legislation was enacted that increased FEMA's borrowing authority from $1.5 billion to $3.5 billion through fiscal year 2008.[10] Additional borrowing authority may be needed to pay claims arising from Hurricanes Katrina and Rita.

[8]GAO, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, GAO-01-992T (Washington, D.C.: July 2001).

[9]*See* 42 U.S.C. 4016.

[10]The National Flood Insurance Program Enhanced Borrowing Authority Act of 2005, Pub. L. No. 109-65 (Sept. 20, 2005).

Premium Subsidies and Repetitive-Loss Properties Affect NFIP's Actuarial Soundness

In reauthorizing the NFIP in 2004, Congress noted that "repetitive-loss properties"—those that had resulted in two or more flood insurance claims payments of $1,000 or more over 10 years—constituted a significant drain on the resources of the NFIP. [11] These repetitive loss properties are problematic not only because of their vulnerability to flooding but also because of the costs of repeatedly repairing flood damages. While these properties make up only about 1 percent of the properties insured under the NFIP, they account for 25 to 30 percent of all claims losses. At the time of our March 2004 report on repetitive loss properties, nearly half of all nationwide repetitive loss property insurance payments had been made in Louisiana, Texas, and Florida. According to a recent Congressional Research Service report, as of December 31, 2004, FEMA had identified 11,706 "severe repetitive loss" properties defined as those with four or more claims or two or three losses that exceeded the insured value of the property.[12] Of these 11,706 properties almost half (49 percent) were in three states—3,208 (27 percent) in Louisiana, 1,573 (13 percent) in Texas, and 1,034 (9 percent) in New Jersey.

As the destruction caused by horrendous 2004 and 2005 hurricanes are a driving force for improving the NFIP today, devastating natural disasters in the 1960s were a primary reason for the national interest in creating a federal flood insurance program. In 1963 and 1964, Hurricane Betsy and other hurricanes caused extensive damage in the South, and, in 1965, heavy flooding occurred on the upper Mississippi River. In studying insurance alternatives to disaster assistance for people suffering property losses in floods, a flood insurance feasibility study found that premium rates in certain flood-prone areas could be extremely high. As a result, the National Flood Insurance Act of 1968, which created the NFIP, mandated that existing buildings in flood-risk areas would receive subsidies on premiums because these structures were built before the flood risk was known and identified on flood insurance rate maps.[13] Owners of structures built in flood-prone areas on or after the effective date of the first flood insurance rate maps in their areas or after December 31, 1974, would have to pay full actuarial rates.[14] Because many repetitive loss properties were

[11] Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, section 2(3),(4), (5), 118 Stat. 712, 713 (2004).

[12] Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem*, RL32972 (Washington, D.C.: June 30, 2005).

[13] 42 U.S.C. 4014(a)(2), 4015(a), (b).

[14] 42 U.S.C. 4014(a)(1), 4015(c)

built before either December 31, 1974 or the effective date of the first flood insurance rate maps in their areas, they were eligible for subsidized premium rates under provisions of the National Flood Insurance Act of 1968.

The provision of subsidized premiums encouraged communities to participate in the NFIP by adopting and agreeing to enforce state and community floodplain management regulations to reduce future flood damage. In April 2005, FEMA estimated that floodplain management regulations enforced by communities participating in the NFIP have prevented over $1.1 billion annually in flood damage. However, some of the properties that had received the initial rate subsidy are still in existence and subject to repetitive flood losses, thus placing a financial strain on the NFIP.

For over a decade, FEMA has pursued a variety of strategies to reduce the number of repetitive loss properties in the NFIP. In a 2004 testimony, we noted that congressional proposals have been made to phase out coverage or begin charging full and actuarially based rates for repetitive loss property owners who refuse to accept FEMA's offer to purchase or mitigate the effect of floods on these buildings.[15] The 2004 Flood Insurance Reform Act created a 5-year pilot program to deal with repetitive-loss properties in the NFIP. In particular, the act authorized FEMA to provide financial assistance to participating states and communities to carry out mitigation activities or to purchase "severe repetitive loss properties."[16] During the pilot program, policyholders who refuse a mitigation or purchase offer that meets program requirements will be required to pay increased premium rates. In particular, the premium rates for these policyholders would increase by 150% following their refusal and another 150% following future claims of more than $1,500.[17] However, the rates charged cannot exceed the applicable actuarial rate.

[15]GAO, *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, GAO-04-401T (Washington, D.C.: Mar. 25, 2004).

[16]Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, section 102(b), (c), 118 Stat. 712, 714 (2004). The act defines a "severe repetitive loss property" to mean single-family properties that have received at least $20,000 in flood insurance payments based on 4 or more claims of at least $5,000 each. The act requires FEMA to define in future regulation which multi-family properties constitute "severe repetitive loss properties."

[17]*Id.*, section 102(h)(1), (2), (3).

It will be important in future studies of the NFIP to continue to analyze data on progress being made to reduce the inventory of subsidized NFIP repetitive loss properties, how the reduction of this inventory contributes to the financial stability of the program, and whether additional FEMA regulatory steps or congressional actions could contribute to the financial solvency of the NFIP, while meeting commitments made by the authorizing legislation.

Data Inconclusive on Compliance with Requirements for Mandatory Purchase of NFIP Policies

In 1973 and 1994, Congress enacted requirements for mandatory purchase of NFIP policies by some property owners in high risk areas. From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance was voluntary. However, because voluntary participation in the NFIP was low and many flood victims did not have insurance to repair damages from floods in the early 1970s, the 1973 act required the mandatory purchase of flood insurance to cover some structures in special flood hazard areas of communities participating in the program. Homeowners with mortgages issued by federally-regulated lenders on property in communities identified to be in special flood hazard areas are required to purchase flood insurance on their dwellings for the amount of their outstanding mortgage balance, up to a maximum of $250,000 in coverage for single family homes. The owners of properties with no mortgages or properties with mortgages held by lenders who are not federally regulated were not, and still are not, required to buy flood insurance, even if the properties are in special flood hazard areas—the areas NFIP flood maps identify as having the highest risk of flooding.

FEMA determines flood risk and actuarial ratings on properties through flood insurance rate mapping and other considerations including the elevation of the lowest floor of the building, the type of building, the number of floors, and whether or not the building has a basement, among other factors. FEMA flood maps designate areas for risk of flooding by zones. For example, areas subject to damage by waves and storm surge are in zone with the highest expectation for flood loss.

Between 1973 and 1994, many policyholders continued to find it easy to drop policies, even if the policies were required by lenders. Federal agency lenders and regulators did not appear to strongly enforce the mandatory flood insurance purchase requirements.[18] According to a recent Congressional Research Service study,[19] the Midwest flood of 1993 highlighted this problem and reinforced the idea that reforms were needed to compel lender compliance with the requirements of the 1973 Act. In response, Congress passed the National Flood Insurance Reform Act of 1994. Under the 1994 law, if the property owner failed to get the required coverage, lenders were required to purchase flood insurance on their behalf and then bill the property owners. Lenders became subject to civil monetary penalties for not enforcing the mandatory purchase requirement.

In June 2002, we reported that the extent to which lenders were enforcing the mandatory purchase requirement was unknown. Officials involved with the flood insurance program developed contrasting viewpoints about whether lenders were complying with the flood insurance purchase requirements primarily because the officials used differing types of data to reach their conclusions. Federal bank regulators and lenders based their belief that lenders were generally complying with the NFIP's purchase requirements on regulators' examinations and reviews conducted to monitor and verify lender compliance. In contrast, FEMA officials believed that many lenders frequently were not complying with the requirements, which was an opinion based largely on noncompliance estimates computed from data on mortgages, flood zones, and insurance policies; limited studies on compliance; and anecdotal evidence indicating that insurance was not always in place where required. Neither side, however, was able to substantiate its differing claims with statistically sound data that provide a nationwide perspective on lender compliance. [20]

[18]The federal entities for lending regulation are the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Farm Credit Administration.

[19]Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem* (June 30, 2005).

[20]GAO, *Flood Insurance: Extent of Noncompliance with Purchase Requirements is Unknown*, GAO-02-396 (Washington, D.C: June 21, 2002).

Accurate, Updated Flood Maps Are The Foundation of the NFIP

Accurate flood maps that identify the areas at greatest risk of flooding are the foundation of the NFIP. Flood maps must be periodically updated to assess and map changes in the boundaries of floodplains that result from community growth, development, erosion, and other factors that affect the boundaries of areas at risk of flooding. FEMA has embarked on a multi-year effort to update the nation's flood maps at a cost in excess of $1 billion. The maps are principally used by (1) the approximately 20,000 communities participating in the NFIP to adopt and enforce the program's minimum building standards for new construction within the maps' identified flood plains; (2) FEMA to develop accurate flood insurance policy rates based on flood risk, and (3) federal regulated mortgage lenders to identify those property owners who are statutorily required to purchase federal flood insurance. Under the NFIP, property owners whose properties are within the designated "100-year floodplain" and have a mortgage from a federally regulated financial institution are required to purchase flood insurance in an amount equal to their outstanding mortgage balance (up to the statutory ceiling of $250,000).

FEMA expects that by producing more accurate and accessible digital flood maps, the NFIP and the nation will benefit in three ways. First, communities can use more accurate digital maps to reduce flood risk within floodplains by more effectively regulating development through zoning and building standard. Second, accurate digital maps available on the Internet will facilitate the identification of property owners who are statutorily required to obtain or who would be best served by obtaining flood insurance. Third, accurate and precise data will help national, state, and local officials to accurately locate infrastructure and transportation systems (e.g., power plants, sewage plants, railroads, bridges, and ports) to help mitigate and manage risk for multiple hazards, both natural and man-made.

Success in updating the nation's flood maps requires clear standards for map development; the coordinated efforts and shared resources of federal, state, and local governments; and the involvement of key stakeholders who will be expected to use the maps. In developing the new data system to update flood maps across the nation, FEMA's intent is to develop and incorporate flood risk data that are of a level of specificity and accuracy commensurate with communities' relative flood risks. Not every community may need the same level of specificity and detail in its new flood maps. However, it is important that FEMA establish standards for the appropriate data and level of analysis required to develop maps for all communities of a similar risk level. In its November 2004 Multi-Year Flood Hazard Identification Plan, FEMA discussed the varying types of data collection and analysis techniques the agency plans to use to develop flood hazard data in order to relate the level of study and level of risk for each of 3,146 counties.

FEMA has developed targets for resource contribution (in-kind as well as dollars) by its state and local partners in updating the nation's flood maps. At the same time, it has developed plans for reaching out to and including the input of communities and key stakeholders in the development of the new maps. These expanded outreach efforts reflect FEMA's understanding that it is dependent upon others to achieve the benefits of map modernization.

Monitoring and Oversight of NFIP Identifies Specific Problems, but Does Not Provide Comprehensive Information on Overall Program Performance

To meet its monitoring and oversight responsibilities, FEMA is to conduct periodic operational reviews of the 95 private insurance companies that participate in the NFIP. In addition, FEMA's program contractor is to check the accuracy of claims settlements by doing quality assurance reinspections of a sample of claims adjustments for every flood event. For operational reviews, FEMA examiners are to do a thorough review of the companies' NFIP underwriting and claims settlement processes and internal controls, including checking a sample of claims and underwriting files to determine, for example, whether a violation of policy has occurred, an incorrect payment has been made, and if files contain all required documentation. Separately, FEMA's program contractor is responsible for conducting quality assurance reinspections of a sample of claims adjustments for specific flood events in order to identify, for example, whether an insurer allowed an uncovered expense, or missed a covered expense in the original adjustment.

The operational reviews and follow-up visits to insurance companies that we analyzed during 2005 followed FEMA's internal control procedures for identifying and resolving specific problems that may occur in individual insurance companies' processes for selling and renewing NFIP policies and adjusting claims. According to information provided by FEMA, the number of operational reviews completed between 2000 and August 2005 were done at a pace that allows for a review of each participating insurance company at least once every 3 years, as FEMA procedures require. In addition, the processes FEMA had in place for operational reviews and quality assurance reinspections of claims adjustments met our internal control standard for monitoring federal programs.

However, the process FEMA used to select a sample of claims files for operational reviews and the process its program contractor used to select a sample of adjustments for reinspections were not randomly chosen or statistically representative of all claims. We found that the selection processes used were, instead, based upon judgmental criteria including, among other items, the size and location of loss and complexity of claims. As a result of limitations in the sampling processes, FEMA cannot project the results of these monitoring and oversight activities to determine the overall accuracy of claims settled for specific flood events or assess the overall performance of insurance companies and their adjusters in fulfilling their responsibilities for the NFIP—actions necessary for FEMA to meet our internal control standard that it have reasonable assurance that program objectives are being achieved and that its operations are effective and efficient.

To strengthen and improve FEMA's monitoring and oversight of the NFIP, we are recommending in today's report that FEMA use a methodologically valid approach for sampling files selected for operational reviews and quality assurance claims reinspections.

FEMA Has Not Fully Implemented NFIP Program Changes Mandated by the Flood Insurance Reform Act of 2004

As of September 2005, FEMA had not yet fully implemented provisions of the Flood Insurance Reform Act of 2004. Among other things, the act requires FEMA to provide policyholders a flood insurance claims handbook; to establish a regulatory appeals process for claimants; and to establish minimum education and training requirements for insurance agents who sell NFIP policies.[21] The 6-month statutory deadline for implementing these changes was December 30, 2004.

In September 2005, FEMA posted a flood insurance claims handbook on its Web site. The handbook contains information on anticipating, filing and appealing a claim through an informal appeals process, which FEMA intends to use pending the establishment of a regulatory appeals process. However, because the handbook does not contain information regarding the appeals process that FEMA is statutorily required to establish through regulation, it does not yet meet statutory requirements. With respect to this appeals process, FEMA has not stated how long rulemaking might take to establish the process by regulation, or how the process might work, such as filing requirements, time frames for considering appeals, and the composition of an appeals board. Therefore, it remains unclear how or when FEMA will establish the statutorily required appeals process.

[21]Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, sections 204, 205, and 207.

With respect to minimum training and education requirements for insurance agents who sell NFIP policies, FEMA published a Federal Register notice on September 1, 2005, which included an outline of training course materials. In the notice, FEMA stated that, rather than establish separate and perhaps duplicative requirements from those that may already be in place in the states, it had chosen to work with the states to implement the NFIP requirements through already established state licensing schemes for insurance agents. The notice did not specify how or when states were to begin implementing the NFIP training and education requirements. Thus, it is too early to tell the extent to which insurance agents will meet FEMA's minimum standards. FEMA officials said that, because changes to the program could have broad reaching and significant effects on policyholders and private-sector stakeholders upon whom FEMA relies to implement the program, the agency is taking a measured approach to addressing the changes mandated by Congress. Nonetheless, without plans with milestones for completing its efforts to address the provisions of the act, FEMA cannot hold responsible officials accountable or ensure that statutorily required improvements are in place to assist victims of future flood events.

We are recommending in today's report that FEMA developed documented plans with milestones for implementing requirements of the Flood Insurance Reform Act of 2004 to provide policyholders a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that flood insurance agents meet minimum NFIP education and training requirements.

FEMA did not agree with our recommendations. It noted that its current sampling methodology of selecting a sample based on knowledge of the population to be sampled was more appropriate for identifying problems than the statistically random probability sample we recommended. Although FEMA's current nonprobability sampling strategy may provide an opportunity to focus on particular areas of risk, it does not provide management with the information needed to assess the overall performance of private insurance companies and adjusters participating in the program—information that FEMA needs to have reasonable assurance that program objectives are being achieved.

FEMA also disagreed with our characterization of the extent to which FEMA has met provisions of the Flood Insurance Reform Act of 2004. We believe that our description of those efforts and our recommendations with regard to implementing the Act's provisions are valid. For example, although FEMA commented that it was offering claimants an informal appeals process in its flood insurance claims handbook, it must establish regulations for this process, and those are not yet complete.

Concluding Observations

The most immediate challenge for the NFIP is processing the flood insurance claims resulting from Hurricanes Katrina and Rita. Already, according to FEMA, the NFIP has received about twice as many claims in 2005 as it did in all of 2004, which was itself a record year. The need for effective communication and consistent and appropriate application of policy provisions will be particularly important in working with anxious policyholders, many of whom have been displaced from their homes.

In the longer term, Congress and the NFIP face a complex challenge in assessing potential changes to the program that would improve its financial stability, increase participation in the program by property owners in areas at risk of flooding, reduce the number of repetitive loss properties in the program, and maintain current and accurate flood plain maps. These issues are complex, interrelated, and are likely to involve trade-offs. For example, increasing premiums to better reflect risk may reduce voluntary participation in the program or encourage those who are required to purchase flood insurance to limit their coverage to the minimum required amount (i.e., the amount of their outstanding mortgage balance). This in turn can increase taxpayer exposure for disaster assistance resulting from flooding. There is no “silver bullet” for improving the current structure and operations of the NFIP. It will require sound data and analysis and the cooperation and participation of many stakeholders.

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be pleased to respond to any questions you and the Committee Members may have.

GAO Contacts and Staff Acknowledgments

Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this statement. For further information about this testimony, please contact Norman Rabkin at (202) 512-8777 or at rabkinn@gao.gov, or William O. Jenkins, Jr. at (202) 512-8757 or at jenkinswo@gao.gov. This statement was prepared under the direction of Christopher Keisling. Key contributors were Amy Bernstein, Christine Davis, Deborah Knorr, Denise McCabe, and Margaret Vo.

PREPARED STATEMENT OF CHRIS LANDSEA

TROPICAL PREDICTION CENTER/NATIONAL HURRICANE CENTER
NATIONAL WEATHER SERVICE
NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION
U.S. DEPARTMENT OF COMMERCE

OCTOBER 18, 2005

Good morning, Mr. Chairman and Members of the Committee. Thank you for inviting me to discuss the outlook for hurricane activity in the future and the storm surge and inland flooding associated with hurricanes. I am Chris Landsea, with the National Hurricane Center in the National Weather Service (NWS) of the National Oceanic and Atmospheric Administration (NOAA), within the Department of Commerce.

The devastation along the Gulf Coast from Hurricane Katrina and Hurricane Rita is like nothing I have witnessed before. Words cannot convey the physical destruction and personal suffering in that part of our Nation. However, without NOAA's forecasts and warnings, the devastation and loss of life would have been far greater.

NOAA's forecasts and warnings for Hurricane Katrina demonstrated the abilities of the state of the art of hurricane prediction. Our continuous research efforts at NOAA, and in partnership with universities and other Federal agencies, have led to our current predictive capabilities and improved ways of describing uncertainty in prediction. Hurricanes pose a major threat to our Nation's coastal communities. The impacts of hurricane winds, storm surge, and inland flooding remain major threats to the Nation. Accurate and timely hurricane forecasts provide emergency managers and the public information needed to prepare for an approaching storm, including considering evacuations, if necessary. Understanding the location and severity of hurricane landfall is the key to planning long before the event.

NOAA strives to improve the reliability, accuracy, timeliness, and specificity of predictions of hazardous weather, such as hurricanes, to help society cope with these phenomena. Over the last 15 years, hurricane track forecast errors have decreased by 50 percent, largely due to advances in hurricane modeling, an increased understanding of hurricane dynamics, improvements in computing and technology, and increased availability of data from the region around the hurricane. Today's 5-day forecasts of a hurricane track are as accurate as 3-day predictions were 20 years ago.

Recently there have been questions raised about NOAA's Hurricane Program. Given the importance to the Nation, NOAA and the Department of Commerce appreciate any insights to improve our forecasts and warnings. NOAA continues to develop new satellite technologies, procure and deploy new buoys, upgrade radiosonde instruments, and invest in additional modeling efforts. The result has been that Hurricane predictions are better today than they have ever been and will continue to improve in future.

While the North Atlantic hurricane season officially lasts from June 1 to November 30, tropical systems have formed in every month of the year. The tropical storms that turn into hurricanes and threaten the East and Gulf coasts of the United States form in the Gulf of Mexico, Caribbean Sea, and Atlantic; many of these storms develop from tropical waves moving off the west coast of Africa. Hurricanes are fueled by warm water as they travel across the ocean; an abundance of warm water provides more energy allowing the storm to increase in strength. However, data indicate that warm water alone is not enough to determine whether a storm will intensify. The winds between the upper and lower levels of the atmosphere (from just above the ocean to about eight miles up) also play a major role. Strong vertical shear (that is a large difference in the speed and direction of the wind between these two levels) in the wind inhibits the formation or intensification of tropical cyclones whereas, weak wind shear encourages them.

An active hurricane season does not necessarily mean more storms make landfall, nor does an inactive period mean no landfalling hurricanes. In 1992, a relatively quiet year, Hurricane Andrew became the costliest disaster in U.S. history at the time, and was the only hurricane to make landfall that year. While anticipating a higher level of activity during hurricane seasons for the next few decades due to multidecadal fluctuations, we do not expect every year to be hyperactive. With more active hurricane seasons, the risk for "major" hurricanes (Category 3 or greater on the Saffir-Simpson scale) to impact the United States or our neighbors in the Caribbean and Central America does increase. It is also important to note that even a weak landfalling storm can cause devastating inland flooding, such as Agnes in 1972 and Allison in 2001. The increase in population and development along our coastline increases the damage potential for an area impacted by a hurricane. The hurricanes of this year and last year provide vivid reminders of the destruction these storms can inflict on our society.

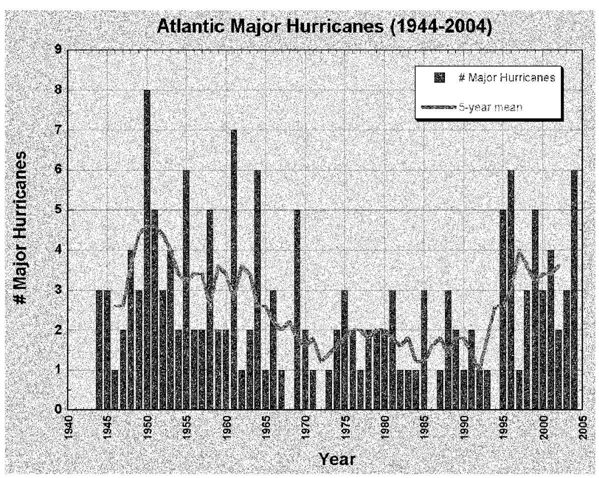
Outlook for Future Hurricanes

In recent decades, the United States had experienced relatively few hurricane landfalls and, in particular, very few "major" hurricanes — those of Category 3 or higher on the Saffir-Simpson hurricane scale (Category 1–5). Our good fortune ended last year when six hurricanes hit the United States, and three of those were major hurricanes. This year to date we have had 20 tropical storms, 11 of which have become hurricanes, and 5 of those have been major hurricanes. Of these five, Dennis, Katrina, and Rita struck the United States as major hurricanes. Most of the deadliest and costliest Atlantic tropical cyclones are major hurricanes. Today, major hurricanes account for just over 20 percent of the landfalling United States tropical storms and hurricanes but cause more than 80 percent of the damage.

The 2005 hurricane season has already been one of the most active on record. In the last 10 years, we have experienced a higher level of North Atlantic hurricane activity. Compared with the previous two and a half decades, more than twice as many major hurricanes have occurred annually (3 to 4 hurricanes on average since 1995 versus 1 to 2 during the period from 1971 to 1994).

Based on changes in oceanic and atmospheric conditions, we believe this increased activity is due to a natural cycle called the Atlantic Multidecadal Mode, a shift in the surface temperature of the North Atlantic and Caribbean Sea between warm and cool phases, with each phase lasting 20 to 40 years. Data suggest we are currently in a warm Atlantic phase; thus, an active Atlantic hurricane era is underway, similar to that last seen from the late 1920's to the late 1960's. Our research suggests that many of the hurricane seasons in the next two or three decades may be much more active than they were in the 1970's through the early 1990's. Warmer sea surface temperatures are expected to contribute to conditions that foster increased hurricane development over this period (see chart below).

Recent research papers by respected scientists have linked global warming changes to increased hurricane intensity. While these researchers have brought up very important questions that need to be addressed, it can still be concluded that the increase in hurricane activity in recent years is due to a natural cycle, rather than man-made causes.



Inland Flooding and Storm Surge

Both storm surge and inland flooding pose significant challenges to both coastal and inland communities. As experienced with Hurricane Katrina, storm surge can be a deadly aspect of hurricanes for which we need to be prepared. Storm surge is water pushed over the shoreline by the force of the winds associated with a hurricane. An advancing storm surge combines with normal tides to create a hurricane storm tide, which can increase the water level to as much as 30 feet or more above normal levels. The direct and indirect effects associated with the massive storm surge from Katrina were responsible for hundreds of lives lost in Louisiana and Mississippi. Loss of life is a function of the physical factors of a storm surge and inland flooding, as well as storm frequency and many sociological conditions, including population density, land use, design and implementation of local and regional preparedness plans, past storm experience, communication, and forecast accuracy.

For coastal counties, storm surge has historically represented the primary tropical cyclone threat. The dangers associated with storm surge apply along the coast, bays, sounds, and coastal sections of rivers. The severity of a surge, as measured by the depth and how far inland the water reaches, depends on a number of natural factors, such as cyclone intensity (surface wind speed) and forward speed of motion, local bathymetry, coastal topographic gradients, and barrier (for example, dune) structure. The level of surge in a particular area is also determined by the slope of the continental shelf. A shallow slope off the coast will allow a greater surge to inundate coastal communities. This rise in water level can cause severe flooding in coastal areas, particularly when the storm surge coincides with the normal high tides. Because much of the densely populated U.S. Atlantic and Gulf coastlines lie less than 10 feet above mean sea level, the danger from storm surge is tremendous. Communities with a steeper continental shelf will not see as much surge inundation, although large breaking waves can also cause serious damage in those areas. Storm surge, waves, and currents in confined harbors result in severe damage to ships, marinas, and pleasure boats.

Freshwater floods from rain present another great threat to life and property in tropical cyclones, and these effects occasionally exceed the coastal impact. While public attention often shifts away as hurricanes move inland, additional death and property damage can occur due to inland flooding from excessive rainfall. For example, the devastation experienced throughout much of eastern North Carolina in the wake of Hurricane Floyd in 1999 was a result of inland flooding. Such floods can occur hundreds of miles inland. As tropical cyclones move inland, their environments, structures, and risks can change markedly from their marine forms. Intense rainfall, not directly related to the wind speed of a tropical cyclone, often causes significant damage. In our Nation, inland flooding is the second leading cause of loss of life from tropical cyclones, behind storm surge. Typically, greater rainfall amounts and flooding are associated with tropical cyclones that have a slow forward speed or stall over an area. Significant rainfall and inland flooding are not only associated with hurricane-strength storms. Some of the more severe flood events have been associated with tropical cyclones which only reach tropical storm strength. The devastation in southeast Texas and the Houston area in 2001 was a result of Tropical Storm Allison.

Two types of inland flooding occur from tropical cyclones: Flash flooding and river flooding. Flash flooding occurs in creeks, streams, and urban areas within a few minutes or hours of excessive rainfall. Rapidly rising water in confined valleys or canyons can reach heights of 30 feet or more. Streets can become swift moving rivers and underpasses can become death traps. River flooding occurs from heavy rains associated with decaying hurricanes or tropical storms, and in extreme cases, river floods can last a week or more.

Since Hurricane Floyd and Tropical Storm Allison, we have taken steps to improve our forecasts of rainfall amounts, extended those forecasts out to 5 days, and incorporated those rainfall forecasts into our river and flood predictions. The NWS conveys the magnitude of observed or forecast flooding using flood severity categories. These flood severity categories include minor flooding, moderate flooding, and major flooding. Each category has a definition based on property damage and public threat. *Minor Flooding* indicates minimal or no property damage, but possibly some public threat or inconvenience. *Moderate Flooding* indicates some inundation of structures and roads near streams. Some evacuations of people and/or transfer of property to higher elevations may be necessary. *Major Flooding* is defined as extensive inundation of structures and roads. Significant evacuations of people and/or transfer of property to higher elevations may be necessary. NWS precipitation frequency estimates are used as design standards for civil infrastructure built to cope with rainfall and runoff, such as storm water drainage systems, roads, bridges, culverts, small dams, etc. These precipitation frequency estimates also contribute to computing flood insurance rate maps and support various planning activities. The estimates help ensure an objective assessment of the probability of heavy rainfall in planning and design.

The impacts of a flood vary locally. For each NWS river forecast location, flood stage and the stage associated with each of the NWS flood severity categories are established in cooperation with local public officials. Impacts vary from one river location to another because a certain river stage (height) in one location may have an entirely different impact than the same level above flood stage at another location.

Future Plans

A key program for increasing our ability to monitor hurricanes, particularly over the data-sparse ocean areas, will be addressed through the Global Earth Observation System of Systems (GEOSS), a 10-year international endeavor of which the United States is a member and NOAA, the National Aeronautic and Space Administration (NASA), and U.S. Geological Survey are key participants.

Using a combination of atmospheric and ocean observations from satellites, aircraft, and all available surface data over the oceans, NOAA, NASA, the National Science Foundation, other Federal agencies, and universities conduct experiments to better understand internal storm dynamics and interactions between a hurricane and the surrounding atmosphere and ocean. Much of NOAA's improvement in tropical cyclone forecasting is attributed to advances in Numerical Weather Prediction (NWP). In collaboration with many scientists and developers in the domestic and international operational NWP centers, the NOAA Environmental Modeling Center develops state of the art numerical modeling systems.

Predicting hurricane intensity, which includes wind structure, storm surge, and rainfall amounts, remains one of our acute challenges. For example, even though we knew conditions were favorable for Katrina and Rita to intensify, and we forecast strengthening, there was some error for both storms in the intensity forecast for the eastern Gulf due to their rapid intensification. To advance hurricane prediction, especially hurricane intensity and size forecasts, NOAA is developing the Hurricane Weather and Research Forecasting (HWRF) system. The HWRF system uses a collaborative approach among the research community and will apply advanced model physics as HWRF couples the atmosphere, land, and ocean into an integrated model. Our goal is to couple an advanced wave model with a dynamic storm surge model to better predict coastal impacts of waves and storm surge.

We have increased our efforts to transfer research into operations. The United States Weather Research Program (USWRP) Joint Hurricane Testbed (JHT) was formed in late 2000. The mission of the JHT is to facilitate the transfer of new technology, research results, and observational advances of the USWRP, its sponsoring agencies, the academic community, and the private sector for improved operational tropical cyclone analysis and prediction. A large portion of my job at the National Hurricane Center is to facilitate and test these new projects for possible implementation into operations. While there are no quick fixes, we expect our continued efforts along these lines will continue to improve predictions of the path of these storms, their intensity, and inland flooding caused by the precipitation from these tropical systems.

Conclusion

Thank you Mr. Chairman and Members of the Committee for this opportunity to discuss the outlook for hurricane activity in the future and the storm surge and inland flooding associated with hurricanes, and how we are working to better prepare our country for these changes. I would be happy to address any questions you may have.

PREPARED STATEMENT OF J. ROBERT HUNTER

DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

OCTOBER 18, 2005

Mr. Chairman and Members of the Committee, I appreciate the invitation to appear before you today to discuss current issues regarding the National Flood Insurance Program. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America. CFA is a nonprofit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy, and education. I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. As Administrator, I ran the National Flood Insurance Program (NFIP) in the 1970's.

Background—My Decade with the Flood Insurance Program

Congress created the NFIP as a result of President Truman's concern that flood insurance was unavailable in areas of Missouri affected by significant flooding. Truman's question led to a major study by the National Academy of Sciences (NAS), the so-called "feasibility study," that determined that there was a way for the Federal Government to underwrite flood insurance.

The NAS approach was elegant: In exchange for a land-use control agreement by a community to steer new construction away from high-risk locations and to otherwise mitigate construction in hazardous zones, the Federal Government would make subsidized flood insurance available to already existing at-risk buildings in the community that agreed to participate. The Federal Government would map each community to show the probability of flooding in a particular area within 100 years.[1] In the 100-year zone, the first floors of new construction would be elevated to the elevation of the 100-year storm. In the highest-risk zones, where water moved with velocity (the floodways of rivers and the storm surge areas) there would be no construction. New construction would not get the subsidized rate but would pay full actuarial rates. If a community granted a variance and allowed a structure to be built below these standards, flood insurance would be available but the price could be extreme. Lenders were required to protect the collateral with flood insurance if the mortgage was on a structure in a high-risk flood zone.

During my tenure at the helm of the NFIP, I learned that Congress was not fully committed to the implementation of the program they designed. I once took a lot of heat from a Congressional delegation when I priced the cost of flood insurance for a well-connected individual's $200,000 home at $50,000 a year because it was built outside of the dunes on a beach and was therefore far more vulnerable to flooding. On another occasion, I almost lost my job as Administrator because I refused to bend in my determination to fully implement the land-use provisions that one powerful senator felt were harmful to some special interests (developers and land owners) in his state. Fortunately, William Proxmire, then the Chair of this Committee, stood by me through these political hurricanes.

In fact, my experience has shown me that political pressure from Congress (sometimes offered with the best of intentions) can threaten the overall viability and effectiveness of the flood insurance program. One danger is the potential for the program to turn into either a back-end disaster relief program (as you know, there have been well-intended but misguided proposals to grant retroactive flood insurance to victims of Hurricane Katrina) or, even worse, a front-end relief program that sells below-actuarially priced insurance to new construction before the flood, exposing taxpayers to unnecessary risk and encouraging unwise construction.

Another danger I have experienced is program error. An environmental group complained to me that the coastal storm surge projections appeared to be too low on our maps. The flood insurance program (the program) engineers were sure they had done the mapping properly, but we discovered that they had left the wave-height off of the storm surge heights, making them far short of the actual 100-year surge. It was a serious scientific error but an even more disastrous political one, as we had to go back to communities that had fought developers to put in place the first maps and raise the required elevations significantly.

During my tenure, I also had to remove private insurers from administering the program for two reasons that are important to reflect on today: A conflict of interest in claims handling and excessive costs for program administration.

The conflict of interest was that insurers, functioning through an association—the National Flood Insurers Association (NFIA)—refused to pay claims the General Counsel of HUD (where the program was housed in the 1970's before it was moved to FEMA) had ruled were covered by the flood insurance policy. Insurers would not pay because they feared that if they paid claims under the flood program that were similar to those they sought to deny under their privately written homeowners' policies with similar policy language, they would have to pay the homeowners' policy claims as well.

The expense problem was that we determined that noncompetitive bids for servicing flood insurance policies had largely been granted by the NFIA's executive committee to the very companies on NFIA's executive committee (that is, self-dealing) and were very expensive. Since the program entailed a subsidy, these excess costs would fall upon taxpayers. We asked for competitive bids but NFIA refused. Ultimately, we removed NFIA from the program. The cost of administering the program fell by half and all claims that were declared to be legitimate by HUD were paid.

Finally, before I was Administrator, I was the Chief Actuary of the NFIP and had the task of making the rates using a multidisciplinary team of hydrologists, land-use experts, underwriters and others. It is a complex job, but the process should be well established by now. Technological developments should make the task easier

[1] The 100-year standard was a compromise between those who felt a tougher standard was required to save lives and property and those who felt the standard should be low to encourage community participation. The 100-year concept is also somewhat misleading in that it is a probabilistic standard of a 1 percent risk of an occurrence within a year. Such an event could actually happen twice in a year, while the average occurrence remains only once in a century (much like flipping a coin could produce five heads in a row while the probability remains at 50 percent).

and more accurate, raising serious questions about why private sector insurers could not develop properly priced flood insurance policies at this juncture and take on at least some of the risk.

I accompanied the first Administrator, George Bernstein, to Mississippi to witness the devastation of Hurricane Camille. At that time, we were briefed by the Corps of Engineers that had Camille struck one degree to the west, New Orleans would have been flooded—in exactly the fashion that occurred with Katrina 35 years later—after the hurricane passed the city and the wind pushed Lake Pontchartrain back over or through the levees. I remember the briefing in great detail because I was born in New Orleans and was shocked at the potential for huge damage and loss of life in my hometown. I am very sad that this happened; particularly given the knowledge we had as a Nation at least as early as 35 years ago, if not since Hurricane Betsy in 1965. It is a tragedy and a scandal that the Federal, State, and local governments did not deal effectively with this known risk in all the intervening years.

NFIP Issues in the Wake of Katrina

Mr. Chairman and Members of the Committee, I have more questions than answers to give to you today since we are all still assessing the full effects of Hurricane Katrina and watching how the NFIP will function in the after-flood runoff of claims. For instance: How will FEMA deal with and audit the obvious conflicts of interest that the Write Your Own insurance companies have in handling, on the same properties, both wind claims adjustments (where the insurer pays 100 percent of the damage found) and flood claims adjustments (where the insurer pays no part of the damage found and indeed gets an adjusting fee for services in handling the claim)?[2] Will claims be paid promptly? How will complaints from policyholders be handled? Will FEMA raise some of the same concerns being raised by attorneys for those without flood insurance when it comes to determining the allocation of flood and wind losses? Were the maps accurate in their 100-year projection . . . if not, why not?

I do, however, have several ideas for your consideration on some of the key questions that this tragic hurricane raises.

Long-Term Solvency

Obviously, Congress cannot decide not to pay legitimate claims to those persons holding flood insurance policies. These policies have the full faith and credit of the country behind them. But Katrina and Rita, with payouts likely to be measured in the tens of billions of dollars, raise the question of how best to make sure the program works in ways that do not bust the Federal budget in the future and indeed minimize taxpayer exposure. In this context, the subsidy of existing structures is an important consideration. When the flood insurance program began, it was assumed that existing structures would, over time, be "washed out" (literally or figuratively) from the program. But there are many subsidized structures still in the program.

I believe that the time has come to find ways to lower the subsidy over the relatively short-term. I submit the following ideas for your consideration:

- A 500-year mitigation and purchase requirement, rather than the current 100-year standard (as I explain below), would mean no subsidies in the areas that have experienced storms between 100-year and 500-year storm levels.
- Subsidies should be immediately ended on structures with market values in excess of some significant amount (for instance $500,000).
- Subsidies should be eliminated on all additional homes for an insured with more than one home.
- Subsidies should be phased out over a certain number of years (perhaps 10) on all structures with market values greater than, for example, $250,000 but less than $500,000.
- Subsidies should be eliminated on all structures that have experienced more than one flood with over $5,000 in program losses in the past.
- Subsidies should be reduced for homes with market values under $250,000 each time the home is sold. This should be done in increments that will eliminate the subsidy over three sales of the structure. Persons who have received flood insurance claims payments or flood disaster relief should not get a subsidy when purchasing a new home.

[2] Attached is our September 12, 2005 letter raising this concern with FIA/FEMA, to which we have had no response.

These ideas require study of course, particularly to assure that they are crafted, as I tried to in the above list, to avoid adversely impacting truly low and moderate-income individuals.

I must raise the question of why private insurers cannot assume a greater role in writing flood insurance? The original reason insurers objected to a private role when NAS conducted the feasibility study was that they said they could not price policies to avoid adverse selection—attracting properties that were extremely likely to be flooded. This concern could be resolved today by using technology to better assess risk and by requiring the purchase of the coverage (perhaps up to the 500-year storm level) to assure the spread of risk. Congress should explore a long-term program to shift flood insurance back into the private sector where political pressures to bring rates below the actuarial level will not be present.

However, if the program is to remain a fully Federal one, then why continue the Write Your Own Program (WYO)? It appears to be terribly expensive[3] and has not accomplished what insurers said it would (that is, increasing market penetration of flood insurance). It results in wind/water claims adjustment conflicts of interest that could be avoided by using competitively bid contractors. When I was Texas Insurance Commissioner, I was shocked that the then Administrator of NFIP refused to give out the program's toll-free telephone number out of fear that agents selling WYO coverage would be upset if the number was publicized. (I had to wait until the Administrator left a press conference to give the number out so Texans who sought to buy flood coverage would have the information and taxpayers would get a break on costs of administration).

I urge this Committee to immediately request a GAO study of the efficiency of the WYO program compared to those of competitively bid contractor programs. Such a study would likely show that the costs of the WYO program are too high, use of contractors should be expanded and the WYO contracts should be renegotiated to save significant taxpayer cost. At the very least, the payment of commission dollars to insurers who do not use commissions (such as USAA) should stop. Why should taxpayers pay agent commissions when no agent receives such commissions?

Coverage levels should also be variable, at the consumer's option. The use of a higher deductible policy with a lower premium is one option that should exist. Policyholders could also be permitted to raise the $250,000 cap on coverage, but only at full actuarial prices, even for currently subsidized structures.

The 100-year storm standard for the elevation of new structures and the purchase requirement within that area should be revisited. Requiring coverage up to the 500-year storm for the Nation would result in greater spread of risk, fewer surprises when storms occur and greater market penetration. The price for flood insurance outside the 100-year area would be very reasonable.

A very serious concern is the low market penetration that the flood insurance program has achieved. Over 2 million homes were insured in the 1970's when I left the program. In 2004, there were only 4.4 million, about double the 1970's level. In less than 10 years, we sold what it took an additional 15 years to match despite amazing population growth along the coasts and lender requirements to purchase insurance in the high flood hazard zones. Something is wrong.

One of the rationales for allowing insurers back into the NFIP was that they would achieve greater market penetration. They have failed to do a very good job other than to receive costly reimbursement for their servicing of policies. Further, the success of the lenders in requiring coverage on properties receiving new loans in flood prone areas is questionable and also needs to be studied. Are lenders failing to follow through to keep homes covered after they are purchased? I am aware that many lenders do have tracking programs to assure continuous coverage. However, questions persist because of the continued low penetration of flood coverage 35 years after the founding of the program. Better market penetration will help assure NFIP solvency.

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[3] I have not been able to get current data from FEMA on this point, but I looked at it a few years ago and this was the case. I have a call into FEMA for the latest information, and I will supply it to the Committee when I get it, if I do get it. The Committee should ask for this information from FEMA to determine the program's actual cost. I suggest not only looking at the costs of service compared to that of a competitively bid contractor but also to compare the cost to that of private insurers selling homeowners insurance (a more complex product than flood insurance and more costly to produce since homeowners insurance is not simply added to a policy as WYO flood insurance is). In 2004, underwriting expenses for the homeowners line were 28.4 percent of written premium, of which commissions were 13.0 percent and State taxes were 2.6 percent—so that the comparable figure for servicing to compare to flood insurance is 12.8 percent (28.4 percent -{13.0 percent + 2.6 percent}). Source: Best's Aggregates & Averages, 2005 Edition.

Consideration should also be given to increasing the amount of mandatory coverage in at least the 100-year flood risk zone. Flood after flood shows market penetration of 10 to 20 percent. This is a serious problem. What is the "hook" for expanding mandatory coverage beyond the purchase requirement on federally backed mortgages, which appears not to work very well all by itself? This is a tough question, but an answer must be found. Perhaps non-Federal lenders could be required by States to get flood cover on high-risk homes. As an incentive, Federal benefits for flood plain management programs in participating States could be increased in those States that required their banks to require flood insurance coverage. A review of Federal benefit programs in high-risk flood areas might reveal other ways to obtain greater mandates on structures/inhabitants in the flood plains. Also, communities could, as part of their flood management requirements to qualify for the NFIP, demand covenants on the sale of properties in flood plains stipulating that flood insurance must be carried in the future. I am not expert in these matters, but it is clear that experts on Federal benefit programs and real estate should help find the answer to this vital question of expanding coverage in high-risk areas.

I have always thought that some of the burden for obtaining coverage for new structures should fall on the builders of these structures. Consideration should be given to requiring builders of new homes to purchase a 30-year (or at least a 5 or 10-year) policy. There are many advantages to this idea, including an immediate infusion of higher premiums into the program; but most important is the mitigation effect that such a requirement will have. Consider the difference in purchase price of two identical homes with builder-purchased flood coverage if one is built in harm's way the other is not. It won't take long for contractors to learn not to build in high-risk areas if they cannot market the high-risk homes.

There should also be verification by a GAO audit that participating communities forbid building in floodways and other "V" Zones, such as storm surge areas. GAO should study the actual development that has taken place after the Flood Insurance Rate Maps (FIRM) were put in place in participating communities to see how the development conforms to the requirements of the FIRM's. If mitigation is not working, costs will go up and people will be killed. Mitigation failures must be fixed or the program will just encourage unwise construction into the future.

Finally, the act to reduce losses to repetitively flooded properties passed by Congress last year should be a significant help in controlling costs.

Map Accuracy

Serious questions have been raised about the accuracy of the maps in Katrina-affected areas. Congress should order a review of the mapping methods and results using actual storms compared to predicted storms in recent years. A team of expert agencies (NAS, NOAA, and others) should review mapping to assure that the most scientifically advanced methods are being used and that errors are not being made. To the extent that maps are not up-to-date and accurate, construction may be occurring at elevations that are dangerous to life and property, and the program may be effectively subsidizing unwise building practices through inadequate flood insurance rates.

While we await this study, I recommend that two steps be taken: (a) Maps should be upgraded at least once every 3 years. (b) Maps should include a 3-year projection of increased flood heights due to development.

WYO Conflicts of Interest: Wind v. Water

Since Hurricane Katrina devastated the Gulf Coast, there has been much public discussion about whether damage to homes was caused by wind and rain, or by flooding. Many policyholders have policies covering wind and rain damage (under homeowners' policies), but not flooding, which is a separate policy underwritten by NFIP.

Despite press releases and public pronouncements by the insurance industry that those without flood insurance should get nothing if their homes were eventually flooded,[4] the situation is far from clear-cut. Some consumers purchased what they were told was full hurricane coverage and were not clearly notified by insurance

[4] The Property Casualty Insurance Association of America, the major industry trade association, issued its first press release with this message on August 31, 2005, and has issued similar press releases nearly every day since.

representatives that flood coverage was not included. They may have been misled. Others were told flood insurance was unnecessary.[5]

Moreover, even though a property may have been washed away by the storm surge, it was likely first hit by heavy winds, so that by the time the water wiped out the property, some percentage of the property was already destroyed by wind and rain. And suppose the storm surge, caused by low pressure, was 10 feet, but wind caused waves on top for another 5 feet. If someone's home is at 12 feet and damaged, was not wind the "proximate" cause of the damage?

Indeed, the outcome of the litigation that is being pursued on this question is not the "slam dunk" that the insurance industry says it is. Some courts have found that where wind and flooding both cause damage, as long as the wind damage is a "proximate" or "efficient" cause of the damage, insurers cannot dodge paying on a claim.

- After Hurricane Camille, this issue was litigated in the Mississippi State courts. The State's highest court confirmed that it was essentially up to a jury to decide whether wind was a proximate cause of the damage and to appropriately apportioned the damage: "[i]t is sufficient to show that wind was the proximate or efficient cause of the loss or damage notwithstanding other factors [that] contributed to the loss."[6] In that case, the policy read: "This coverage does not insure against loss . . . caused by, resulting from, contributed to or aggravated by . . . flood, surface waters, tidal water, or tidal wave, overflow of streams or other bodies of water, or spray from any of the foregoing, all whether driven by wind or not."[7]
- Mississippi is not the only State where this approach is taken. Other courts have also found that in cases of total damage caused by a possible combination of a covered peril (wind) and other excluded perils (flood), where the proximate cause of damage is a covered peril, insurers must pay the claim.[8] As the Ninth Circuit has explained, "in determining whether a loss is within an exception in a policy, where there is a concurrence of different causes, the efficient cause—the one that sets the others in motion—is the cause to which the loss is to be attributed, though the other causes may follow it, and operate more immediately in producing the disaster."[9]

Courts have repeatedly held that disputes over ambiguous contract language, such as in a homeowner's policy, are to be resolved in the policyholder's favor.

- It has been settled law for over 100 years that where language in insurance policies is ambiguous, questions will be resolved in favor of the policyholder.[10]
- According to a West Virginia court, "[a] provision in an insurance policy may be deemed to be ambiguous if courts in other jurisdictions have interpreted the provision in different ways. This rule is based on the understanding that one cannot expect a mere layman to understand the meaning of a clause respecting the meaning of which fine judicial minds are at variance."[11]

The attitude of the insurance industry in the aftermath of Hurricane Katrina, as they force policyholders to fight to get their claims paid, is consistent with the industry's efforts to limit claims payouts in other hurricane situations.

- In Florida, in the aftermath of Hurricane Andrew, a court ordered insurance companies to pay their full claims, relying on an explicit statutory provision called a "value added" law, which stated that a policy that covers one peril, even if it expressly excludes another possible contributing peril, must be paid in full.[12] The insurance industry's response was to lobby the legislature to change the law, which occurred.[13]

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[5] Reports to the Americans for Insurance Reform Katrina Insurance Hotline indicate that when policyholders were purchasing homeowners' insurance, insurance agents said that additional flood insurance would not be necessary, as the policyholders did not live in flood zones.

[6] *Grace* v. *Littitz Mutual Ins. Co.,* 257 So.2d 217, 224 (Sup. Ct. Miss. 1972) (citing *Lititz Mut. Ins. Co.* v. *Boatner,* 254 So.2d 765 (Miss. 1971); *Kemp* v. *American Universal Ins. Co.,* 391 F.2d 533 (5th Cir. 1968)).

[7] Id. at 219.

[8] *Murray* v. *State Farm Fire and Casualty Co.,* 509 S. E.2d 1, 11 (W.Va. 1998) (When a loss is caused by a combination of covered and specifically excluded risks, the loss is covered if the covered risk was the proximate cause of the loss.); *Bartholomew* v. *Cameron Country Mut. Ins. Co.,* 882 S. W.2d 173 (Mo. Ct. App. W.D. 1994).

[9] *Berry* v. *Commercial Union Ins. Co.,* 87 F.3d 387 (9th Cir. 1996) (quoting *Sabella* v. *Wisler,* 377 P.2d at 895).

[10] *McMaster* v. *New York Life Ins. Co.,* 22 S. Ct. 10 (2001).

[11] Murray, at FN5.

[12] *Mierzwa* v. *Florida Windstorm Underwriting Assoc.,* 877 So.2d 774 (Fla. Dist. Ct. App. 2004).

[13] *http://www.independentagent.com/VU/NonMember/DisasterFAQs.htm; http://www.insurancenewsnet.com/print.asp?a=top-pc&lnid=5390280.*

The importance of this legal dispute to the flood insurance program is obvious. To the extent that insurers underpay wind when allocating damage between their homeowners' policy and the NFIP policy, taxpayers will suffer. It is also true that the more lax the Federal Government is in demanding that the allocation be fair to taxpayers, the more likely it is that persons without flood insurance will receive unfair or no compensation under their wind policies. Take the situation of two damaged homes next to each other, one with flood coverage and one without. If the Federal Government is vigilant regarding the home with flood coverage and the resulting allocation is 50/50 versus the insurer suggestion of 25 percent wind/75 percent flood, the insurer will be hard-pressed to assess the similarly damaged home next door at 25 percent wind damage.

For the benefit of taxpayers' and those with no flood insurance, it is essential that the Government assure a fair and proper allocation of the wind/flood damage by the WYO insurance companies who have a serious conflict of interest. CFA urges this Committee to insure that the GAO audits these allocations starting right now, so that any tendency of the insurers to diminish their wind losses for their own benefit is stopped quickly.

Conclusion

It is vital to the Nation that the NFIP work efficiently and comprehensively to protect as many Americans as possible against floods that occur in the future. There are serious questions about how the program is working today that cry out for study and resolution. Today's hearing is an important first step in accomplishing this important task. I will be happy to respond to questions at the appropriate time.

Consumer Federation of America

September 12, 2005

David I. Maurstad
Acting Director, Mitigation Division
and Federal Insurance Administrator
Federal Insurance Administration/FEMA
500 C Street, SW
Washington, D.C. 20472

Dear Administrator:

As a former Administrator of the Flood Insurance Program, I am concerned about the potential for claims settlement abuses in the aftermath of Hurricane Katrina. On the one hand, FIA must pay claims promptly in a very complex situation. On the other, the potential for taxpayers to be overcharged by insurers claiming illegitimate flood losses is real.

I urge you to bring in the CEOs of the major write-your-own insurers and tell them that, when there is a loss to be adjusted where both wind and flood damage is present, they should not hold up payments during the determination period. They should pay the claim promptly, make the best determination of the wind/flood allocation possible and carefully document that allocation.

I would also urge you to tell them that you fully understand that there is potential for abuse by insurers and that you will carefully audit all allocations where there is both wind and flood damage. Insurers that also have wind coverage on a particular property have a conflict of interest in adjusting flood claims, as wind payouts come out of their reserves and flood payouts do not.

I believe GAO should be brought into the auditing of how these claims are allocated at once. I will soon be asking the appropriate Congressional Committee Chairs and Ranking Members to consider this action.

I also urge FIA to continue to require a separate adjuster for flood losses when both wind and flood damage is present. I was very concerned to read this statement in the September 8th *New York Times* about a meeting of insurers and regulators in Atlanta:

> The attendees also discussed the convention of using separate insurance adjusters to assess wind damage and water damage. The consensus seemed to be that using one adjuster would streamline the process and make it less contentious.

"Less contentious" in this case could well mean less protection for the taxpayer. When the insurer can profit by pretending that wind damage is in fact flood damage, having separate adjusters is an essential step in helping to keep the process honest.

I look forward to your action and response.

Yours truly:

J. Robert Hunter

J. Robert Hunter
Director of Insurance

cc: The Honorable Richard C. Shelby
The Honorable Paul S. Sarbanes
The Honorable Michael G. Oxley
The Honorable Barney Frank
The Honorable Richard H. Baker
The Honorable Paul E. Kanjorski

PREPARED STATEMENT OF DOUGLAS J. ELLIOTT

PRESIDENT, CENTER ON FEDERAL FINANCIAL INSTITUTIONS

OCTOBER 18, 2005

Good morning. Thank you for inviting me here today. I commend Chairman Shelby, Ranking Member Sarbanes, and the Committee Members for moving quickly to start a thorough reexamination of the flood insurance program.

I am the President of the Center On Federal Financial Institutions or COFFI for short. This is the first time in our young history that anyone from COFFI has appeared before your Committee, so let me briefly explain who we are. We are a nonpartisan and nonprofit think tank focused on the Federal Government's massive activities as lender and insurer. Our role is educational. Federal financial institutions are complex and we want to help policymakers fully understand their options without imposing our own views. In that vein, *The New York Times* referred to our work as "without a hint of dogma or advocacy."

The devastation wrought by Katrina underlined three major problems at the flood insurance program, viewed as a Federal financial institution:

- We cannot persuade most of the target market to buy the policies.
- The insurer's financial resources are insufficient for expected claims.
- Budget accounting for the program is structurally misleading.

The greatest damage stems from the low participation rates, since each victim of Katrina who failed to insure their home faces a major financial shock on top of their other traumas. Precise figures for participation are difficult to come by, which is a problem in itself, but it appears that fewer than 30 percent of vulnerable homeowners were insured nationwide.

Floods can be more frequent than fires and equally damaging, so why don't more homeowners carry flood insurance, as they do fire insurance? The full answers are complex and are discussed in great detail in an attachment to our written statement, but the simple version is this.

First, there are major economic disincentives to buying flood insurance. Uninsured flood victims receive substantial benefits unavailable to insured homeowners. The National Flood Insurance Program (NFIP) indicates that every three dollars of flood insurance claims payments reduce the value of Federal disaster aid by one dollar. Flipping this around, insurance purchasers forego aid worth one-third of their entire claims payment. They may also forego State, local, and charitable aid. On top of this, flood losses are generally tax-deductible, while flood insurance premiums are not. Thus, a purely rational homeowner has many reasons not to buy the insurance.

Second, considerable research suggests that most people have a strong irrational bias against buying insurance covering infrequent catastrophe losses. It feels like throwing away money to them. This perception can be countered to some extent by how the insurance is framed, but the bias is difficult to eliminate completely.

Third, our existing mandatory provisions are leaky. The main one, which uses mortgage lending as the trigger, suffers from three disadvantages:

- One study found that 34 percent of coastal dwellers vulnerable to flooding had no mortgage.
- Only federally regulated mortgage lenders and GSE's are covered.
- It appears that some homeowners cancel their flood coverage without lenders taking action.

Another mandatory provision, that aid recipients must carry flood insurance in the future, is relevant to only a portion of future claims and suffers from leakage problems as well.

So what can be done? Efforts to increase voluntary purchases are worth considering, but, unfortunately, it will almost certainly take tougher mandatory provisions to significantly boost participation, given the economic disincentives and pyschological biases. This is not just my view. COFFI recently held a policy forum on flood insurance and there was a consensus that stronger mandatory mechanisms are the only way to sharply increase participation. I would add that this is even more likely to be necessary if premium rates are boosted to deal with the financial implications of Katrina.

Enforcement of current provisions could be tightened by stricter review of whether mortgage borrowers maintain their flood insurance and possibly by expanding the mandate to non-federally regulated lenders. However, even these actions would still leave many uncovered—at a minimum the 34 percent or so who do not hold mortgages. A more radical solution would be to require that homeowners' policies in flood-prone areas include flood insurance, with the Federal program continuing to take the actual financial risk. Issues of Federal regulation could perhaps be finessed by coordination with the National Association of Insurance Commissioners.

Despite the many uninsured, the flood insurance program will lose well over $10 billion on Katrina. This highlights a fundamental structural problem. The flood insurance program charges roughly one-third less in premiums than its actuaries believe would be necessary to cover long-term expected costs. This is because structures which existed before a community signed up for the program receive a subsidy of roughly $1.3 billion a year while newer structures pay approximately their actuarial cost. That represents a subsidy of just under 40 percent for the program as a whole.

This subsidy is not necessarily wrong. It is for you to decide whether taxpayers from across the Nation should subsidize those living in flood-prone areas. There are reasonable arguments either way.

What IS wrong is the lack of transparency. There is nothing in the budget numbers to show the subsidy. Nor does the National Flood Insurance Program make such a number readily available. They have an excellent and well-written Actuarial Review on their website that explains the subsidy mechanism, but stops short of providing an aggregate figure. The last public number I found was in a GAO report of a few years ago which gave a figure of $500 million a year. I had to do some simple math to arrive at the updated $1.3 billion figure.

The NFIP Actuarial Review of November 2004 states that "were the catastrophic contingency contemplated in establishing all rate levels, the Pre-FIRM subsidized portion of the business would have to pay about two and a half times the current premium, and the overall target level for premiums would have to increase on the order of 50 percent to 75 percent." Those percentages correspond to $1.0 to $1.5 billion of extra premiums, based on 2004 levels. Our calculations from more detailed numbers provided in the same review put the figure at $1.3 billion.

Ideally, the taxpayer subsidy would be shown on-budget, but it is important either way that the figure be clear and readily available. There is currently a misconception among some that the flood insurance program is self-supporting, since it has been able to pay back its loans from the Treasury Department over the last 20 years. This is true, but misleading. The flood insurance program is structured in a way that should be expected to require taxpayer money over time. It is impossible to give over a quarter of policyholders, the riskiest ones at that, a 60 percent discount from actuarially fair rates without either overcharging the other policyholders an equal amount or eventually receiving government appropriations.

There is a danger in underpricing insurance and not admitting it, as we are seeing now with another program on which COFFI has done considerable work, the Pension Benefit Guaranty Corporation. That program has never charged premiums adequate to its risks, but still reported contributions to Federal deficit reduction because of perverse budget rules. Everyone was happy with an untenable situation until PBGC started losing $10 billion a year on a GAAP accounting basis, losses that will eventually work their way through to the Federal budget.

Finally, we must seriously consider the possibility that Katrina's losses were not AS improbable as the program's models would have suggested. It may be that all policies are currently subsidized, due to unrealistically optimistic assumptions about future losses from the most catastrophic hurricanes.

Thank you. The remainder of my written testimony consists of a more thorough 17-page review of many of these issues, which we published a few weeks ago. We also have other material available at *www.coffi.org*. This will shortly include both a transcript and a summary of the flood insurance policy forum that we recently held.

PREPARED STATEMENT OF ROBERT P. HARTWIG, Ph.D., CPCU

SENIOR VICE PRESIDENT & CHIEF ECONOMIST

INSURANCE INFORMATION INSTITUTE, NEW YORK, NY

OCTOBER 18, 2005

Thank you, Mr. Chairman, and Members of the Committee, my name is Robert Hartwig and I am Chief Economist for the Insurance Information Institute, a property/casualty insurance trade association. I have been asked to testify before the Committee regarding the future of the National Flood Insurance Program (NFIP). Specifically, I have been asked to offer observations from an insurance industry perspective on how the NFIP can better manage the challenges it faces, employing strategies, techniques, and organizational behaviors commonly found in the private insurance sector.

Background

Hurricane Katrina caused death, destruction, and economic dislocation on a scale not seen from a natural disaster in this country since the 1920's. Indeed, from 2000 through the mid-1960's, hurricanes killed more than 15,000 people—most by drowning—and entire communities were washed away. Even today, flood remains the second leading cause of death from natural disasters, with recent floods from New Orleans to New England providing us with grim reminders. In 1968, in response to the rising cost of taxpayer-funded disaster relief for flood victims and the increasing amount of damage caused by floods, Congress enacted the National Flood Insurance Act, creating the National Flood Insurance Program (NFIP). This hearing today harkens back to that era, a time when the questions about what can and should be done about reducing flood risk were at the fore.

Much has been accomplished over the 37 years that the NFIP has been in existence and, in many respects, the NFIP operates like a private insurance company. The Federal flood insurance program combines the concepts of insurance protection—which allows people and businesses to efficiently transfer risk in exchange for a premium—with hazard mitigation. In exchange for making federally backed flood insurance available for residential and commercial properties, communities must agree to adopt and enforce floodplain management ordinances to reduce future flood damage.

While the approach appears reasonable, the fact remains that in the wake of Hurricanes Katrina and Rita, the program must now borrow an estimated $10 billion to $30 billion from the U.S. Treasury to meet its fiscal year 2005 obligations, including $2 billion already authorized by Congress last month, despite the fact that the overwhelming majority of property owners affected by the storms and who were vulnerable to flood losses had not purchased flood coverage. This suggests several serious structural and incentive-based problems not only within the NFIP itself, but also among other stakeholders, including lending institutions, State and local governments and at-risk property owners. Fortunately, there are solutions for most of these problems, which fall into two broad categories:

- the need to reflect the true cost of insuring against the peril of flood by adopting a policy of charging actuarially sound rates, thereby reducing the risk to taxpayers, and;
- an urgent need to dramatically increase participation rates in the Federal flood insurance program in order to avoid a repeat of future human and economic tragedies on the scale of Katrina or worse.

Pricing: Moving Toward Actuarially Sound Rates

As this year's significant shortfall in the NFIP's claims paying resources illustrates, premiums collected are insufficient to cover losses incurred after extreme events. This year's $10 to $30 billion in losses are some 5 to 15 times more than the $2 billion the program collected in premiums in 2004. Were it a private insurer the NFIP would be bankrupt. Private insurers are expected to pay up to $60 billion on 1.6 million claims from Hurricane Katrina alone, entirely from private resources. While the NFIP has made strides in improving the actuarial soundness of rates, and in a "normal" year the program does not operate with a deficit, in the world of insurance there is no such thing as "normal," only an average of extremes. Adopting a formal policy of actuarially sound pricing for all flood policies would create a more fair and equitable system for all plan participants that would minimize subsidies, discourage unwise development and greatly reduce the risk to taxpayers. Fortunately, data and technology exist today that would allow the NFIP to move swiftly in this direction. Available historical data on flooding is extensive, flood maps (many of which are decades old) could be updated to improve accuracy in underwriting and risk assessment and state-of-the-art catastrophe models could be developed to help estimate risk and cost, as is currently done for hurricane and earthquake risk.

Actuarially sound rates, by definition, must *fully* account for the risk being underwritten, including the possibility of mega-catastrophes such as Hurricane Katrina. To that end, all private insurers accumulate substantial pools of claims paying capital to accommodate the possibility, no matter how remote, of large-scale losses. Consequently, the NFIP should charge premiums that, in addition to being sufficient to pay annual losses in most years, generate a surplus that allows the program to build claims-paying capacity over time. That stock of claims paying capital must be placed in a "lockbox," untouchable for any other purpose.

Finally, there are occasions when the actuarially sound decision is to refuse to underwrite coverage at any price—in other words to just say no. There are hundreds of thousands of coastal structures today that would have never been built were it not for the implicit guarantees of a myriad of government-run insurance enterprises including the NFIP. Today, plans in nearly 30 States plus the NFIP issue approximately 6.6 million policies across the United States with a face value of some $1.2 trillion. Many operate with deficits. Among 27 State-run high-risk property insurers in 2003 (latest year for which data are available), 15 posted an operating loss, a year with relatively light catastrophe activity. These deficits are paid off through assessments levied on virtually every property owner in the State, including those who live hundreds of miles from the coast.

Increasing Participation in the National Flood Insurance Program

Approximately 275,000 homes were destroyed or damaged beyond economic repair by Hurricane Katrina, 10 times the number destroyed by Hurricane Andrew or the four storms that hit Florida last year (Exhibit 1). Hundreds of thousands of others were damaged. Despite Katrina's ferocious winds, water was the principle cause of economic dislocation. According to AIR Worldwide, a disaster modeling firm, flooding, including storm surge, from Katrina caused $44 billion in damage to structures, most of it uninsured (Exhibit 2). Tragically, however, fewer than 10 percent of property owners in some coastal counties had purchased flood coverage (Exhibit 3). This figure is astonishingly low, given the obvious risk in low-lying coastal communities, the fact that some of these same areas had been devastated by hurricanes in the past and the four warning shots Mother Nature fired over the bow of the Gulf States in 2004, not to mention the fact that the region affected by Katrina has a long and miserable history of river flooding (Exhibit 4). The NFIP also for many years has sought to increase awareness of flood risk through a variety of highly visible marketing campaigns.

So the question remains, why don't people buy flood coverage?

- *Denial*—the belief that "it won't happen to me" is ubiquitous and rooted in a fundamental misperception of risk. People translate the risk of living in a 1-in-100 year flood plain as a mere 1 percent chance of experiencing a flood over the course of an entire century, for example. In reality, a property owner in a 1-in-100 year flood plain has a 26 percent chance of being flooded during the course of a 30-year mortgage;
- *Cost*—when given the option of buying coverage at a relatively modest $438 per year on average—and potentially much less in low-risk areas (Exhibit 5), most people will decline, even though the cost is small relative to the value of the home and turning down the coverage amounts to playing Russian roulette with the typical family's most valuable asset;
- *Government Aid*—why buy insurance if the Government is going to bail me out anyway? There is a widespread belief that large amounts of Government aid will be made available to disaster victims *after* an event and so there is little point in buying flood coverage if largely the same benefit is available for free (Exhibit 6). This perception would only be reinforced if property owners are allowed to buy into the NFIP retroactively;
- *Legal Action*—attorneys general and trial lawyers in some Katrina-impacted States are suing private insurance companies to force them to pay flood losses, Mississippi in particular. Though it is a well-known fact that flood damage has been excluded from all homeowners insurance policies for decades (Exhibit 7) and that private insurers have never received a dime in premiums to cover flood-related losses, these suits spread false hope among desperate people that clever lawyering can produce flood coverage where none, in fact, exists. In the remote likelihood that such suits were to be successful, an immediate national crisis in the availability and affordability of homeowners insurance would ensue and the NFIP's very reason for existence would be threatened (Exhibit 8). Why buy flood coverage from the NFIP when you can just sue your homeowners insurer and get it for free?

For the NFIP to be truly effective, it must overcome these obstacles and dramatically increase the proportion of at-risk properties that are insured and *stay* insured through the program. Tens of millions of homes and businesses are vulnerable to at least modest flood risk, but in 2004 just 4.7 million property owners purchased flood coverage through the NFIP. Increased marketing and educational efforts are likely to be of only marginal value. Even mega-disasters such as Katrina create only a temporary surge in demand and many of the recently purchased policies will soon be allowed to lapse. In fact, approximately 10 to 15 percent of NFIP policies lapse annually. Moreover, the reality is that government aid *will* flow after major disasters, possibly in ever larger amounts. Therefore, the ability to significantly increase flood insurance penetration rates and to sustain them is largely beyond the NFIP's capability, given the economic incentives at-risk property owners have to not buy insurance.

The most efficient way to substantially increase the NFIP's penetration rate among property owners is to expand mandatory participation through a lender-based system that ensures that flood coverage is in-force at all times for all mortgaged properties within 100-year flood plains and beyond. Lenders require the purchase of standard homeowners insurance with the result that 96 percent of homeowners carry the coverage. If a mortgage holder fails to buy insurance, the lender is legally authorized to secure the coverage at the property owner's expense. Such a system, when combined with actuarially sound rates and an accumulation of reserves in an NFIP "lockbox" would effectively eliminate the risk to the U.S. taxpayer for the vast majority of disaster scenarios.

Implications of Inaction

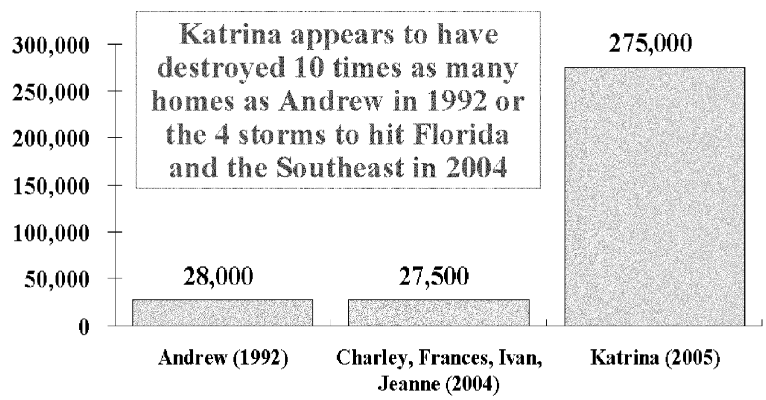
The value of privately insured coastal structures in hurricane exposed areas today exceeds $7.2 trillion or about 60 percent of GDP (Exhibit 9). But as the severe flooding in the Northeast over the past week illustrates, flood poses a risk virtually everywhere. The consequences of inaction are grave. Katrinas of the future could be far more devastating and occur with greater frequency, jeopardizing hundreds of thousands of jobs, shattering families and communities and saddling the U.S. taxpayer with a burden it can ill-afford, given current record Federal deficits.

America's clear national interest lies in making sure that the National Flood Insurance Program remains financially secure and accessible, while sending market-based price and underwriting signals based on sound actuarial principles concerning risk.

Thank you for the opportunity to appear at today's hearing. I would be happy to answer any questions you may have.

Exhibit 1

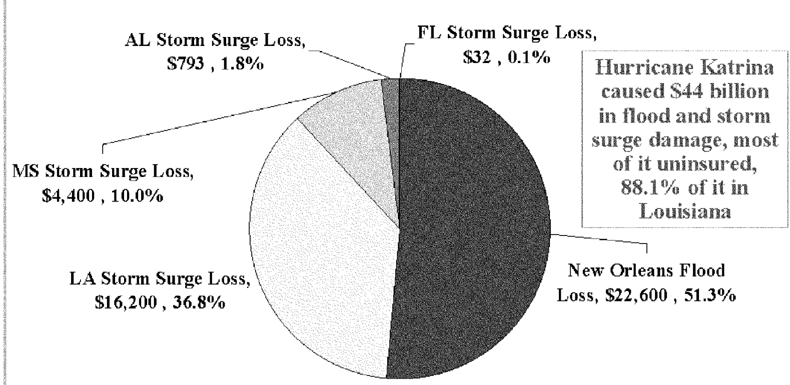
*Number of Homes Destroyed by Major Hurricanes**



*Destruction is defined as a structure made uninhabitable or damaged beyond economic repair.
Source: National Association of Home Builders, National Red Cross (as of 9/15/05).

Exhibit 2

*Property Damage from Hurricane Katrina Flood & Storm Surge (\$ Millions)**



*Value of property damage by flood and storm surge *whether or not insured.*
Source: AIR Worldwide, September 29, 2005.

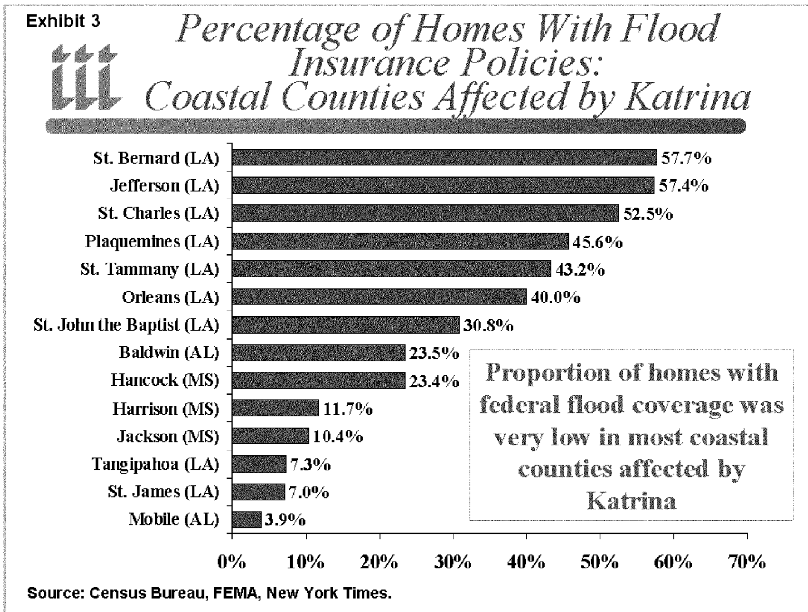


Exhibit 3
Percentage of Homes With Flood Insurance Policies: Coastal Counties Affected by Katrina
St. Bernard (LA) 57.7%
Jefferson (LA) 57.4%
St. Charles (LA) 52.5%
Plaquemines (LA) 45.6%
St. Tammany (LA) 43.2%
Orleans (LA) 40.0%
St. John the Baptist (LA) 30.8%
Baldwin (AL) 23.5%
Hancock (MS) 23.4%
Harrison (MS) 11.7%
Jackson (MS) 10.4%
Tangipahoa (LA) 7.3%
St. James (LA) 7.0%
Mobile (AL) 3.9%
Proportion of homes with federal flood coverage was very low in most coastal counties affected by Katrina
0% 10% 20% 30% 40% 50% 60% 70%
Source: Census Bureau, FEMA, New York Times.

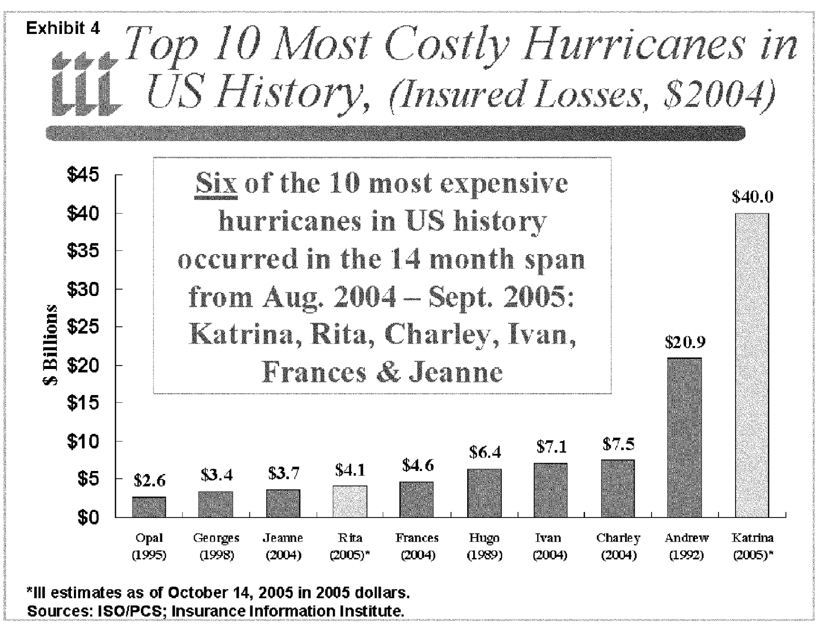


Exhibit 4
Top 10 Most Costly Hurricanes in US History, (Insured Losses, $2004)
Six of the 10 most expensive hurricanes in US history occurred in the 14 month span from Aug. 2004 – Sept. 2005: Katrina, Rita, Charley, Ivan, Frances & Jeanne
$ Billions
$45 $40 $35 $30 $25 $20 $15 $10 $5 $0
Opal (1995) $2.6
Georges (1998) $3.4
Jeanne (2004) $3.7
Rita (2005)* $4.1
Frances (2004) $4.6
Hugo (1989) $6.4
Ivan (2004) $7.1
Charley (2004) $7.5
Andrew (1992) $20.9
Katrina (2005)* $40.0
*III estimates as of October 14, 2005 in 2005 dollars.
Sources: ISO/PCS; Insurance Information Institute.

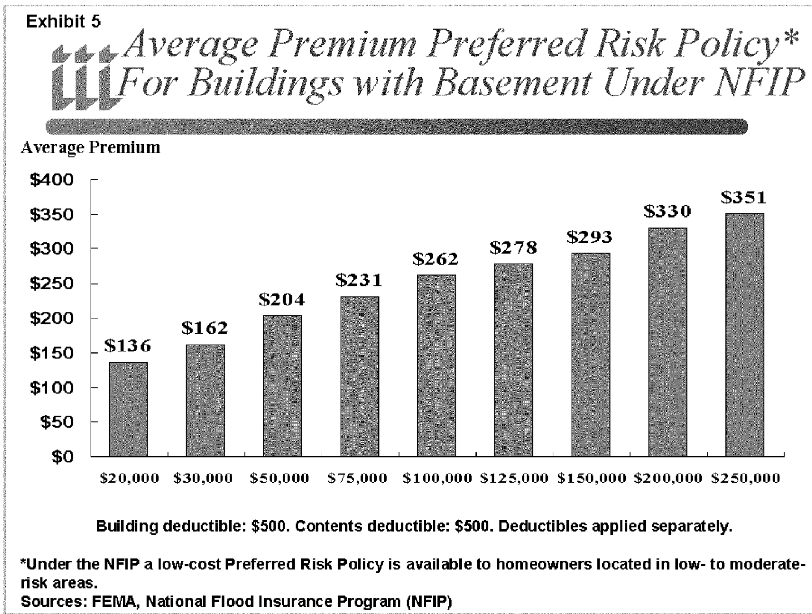


Exhibit 5
Average Premium Preferred Risk Policy*
For Buildings with Basement Under NFIP
Average Premium
$400
$350
$300
$250
$200
$150
$100
$50
$0
$136
$162
$204
$231
$262
$278
$293
$330
$351
$20,000
$30,000
$50,000
$75,000
$100,000
$125,000
$150,000
$200,000
$250,000
Building deductible: $500. Contents deductible: $500. Deductibles applied separately.
*Under the NFIP a low-cost Preferred Risk Policy is available to homeowners located in low- to moderate-risk areas.
Sources: FEMA, National Flood Insurance Program (NFIP)

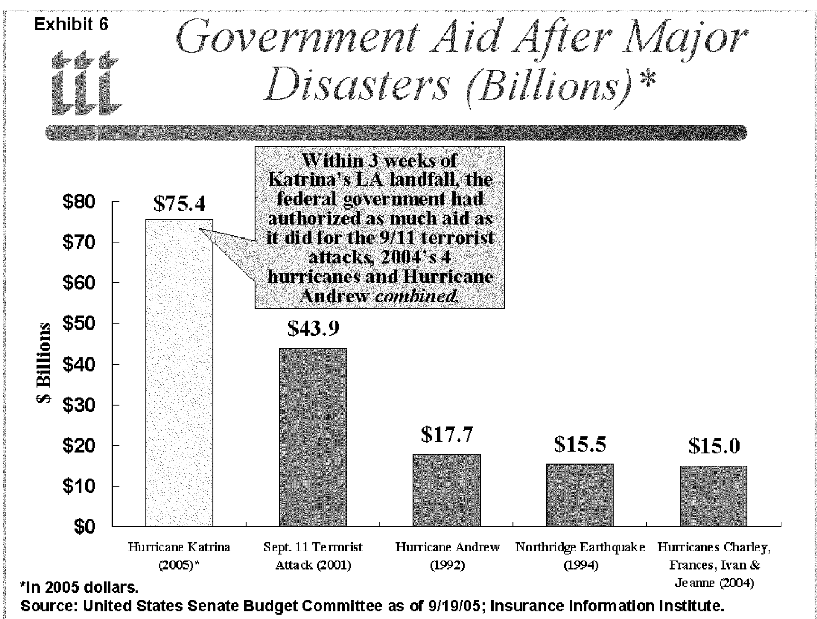


Exhibit 6
Government Aid After Major Disasters (Billions)*
Within 3 weeks of Katrina's LA landfall, the federal government had authorized as much aid as it did for the 9/11 terrorist attacks, 2004's 4 hurricanes and Hurricane Andrew combined.
$ Billions
$80
$70
$60
$50
$40
$30
$20
$10
$0
$75.4
$43.9
$17.7
$15.5
$15.0
Hurricane Katrina (2005)*
Sept. 11 Terrorist Attack (2001)
Hurricane Andrew (1992)
Northridge Earthquake (1994)
Hurricanes Charley, Frances, Ivan & Jeanne (2004)
*In 2005 dollars.
Source: United States Senate Budget Committee as of 9/19/05; Insurance Information Institute.

Exhibit 7

Itemization of Federal Government Spending on Hurricane Relief

Legislation	5-Yr. Cost	Status
Emergency Spending Supplement #1, HR 3645	$10.500	Public Law 109-61
Emergency Spending Supplement #2, HR 3673	$51.8	Public Law 109-62
Flood Insurance Borrowing Authority	$2.000	Passed House & Senate
Pell Grant Relief, H.R. 3169	$0.002	Passed House & Senate
TANF Disaster Relief, H.R. 3672	$0.294	Passed House & Senate
Katrina Short-Term Tax Relief Bill, H.R. 3768	$6.500	Passed Senate
Sarbanes Housing Amend. To H.R. 2862	$3.500	Passed Senate
Harkin Legal Services Amend. To H.R. 2862	$0.008	Passed Senate
Snowe Small Business Amen. To H.R. 2862	$0.595	Passed Senate
Baucus Economic Develop. Amend to H.R. 2862	$0.210	Passed Senate
TOTAL	**$75.409**	
Emergency Health Care Relief Act, S. 1716	$5.0-$7.0B	Introduced in Senate
Additional Flood Insurance Borrowing Authority	$10.0-$30.0B	N/A

Exhibit 8

Typical Flood Exclusion in Homeowners Insurance Policy

- **Flood Exclusion**
  - **Water Damage, meaning any loss caused by, resulting from, contributed to or aggravated by:**

1. ***flood, surface water, waves, tidal water or overflow of any body of water***, or spray from any of these, ***whether or not driven by wind.***
2. Water or water-borne material which backs up through sewers or drains, or which overflows or is discharged from a sump pump, sump pump well or other system that is designed to remove subsurface water which is drained from the foundation area; or
3. Water or water-borne material below the surface of the ground, including water which exerts pressure on, or flows, seeps or leaks through any part of a building, sidewalk, foundation, driveway, swimming pool or other structure or water that causes earth movement.

This exclusion applies whether or not the water damage is caused by or results from human or animal forces or any act of nature.

Exhibit 9

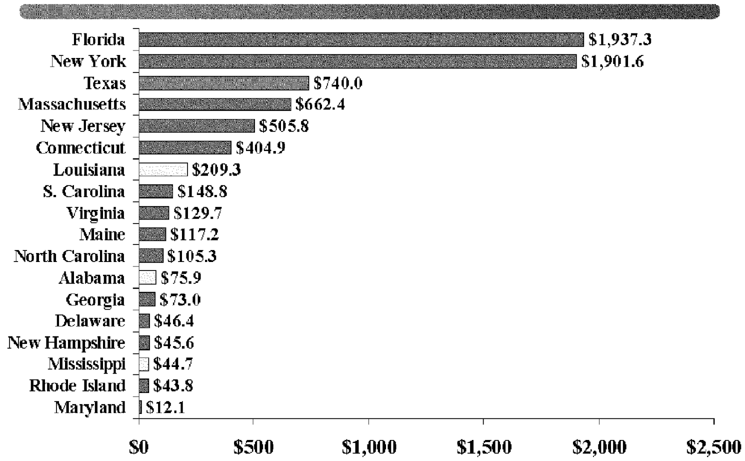
Consequences of Mississippi AG's Actions

- **Sept. 15 suit by MS AG Hood constitutes and attempt to retroactively rewrite all HO insurance contracts in MS. *"Contract certainty" extinguished.***
- **Suit amounts to little more than an attempt to expropriate shareholder assets (and the equity of mostly non-MS policyholders of mutual insurers)**
- **The risk is fundamentally political, cannot be modeled or priced**
- **Insurers will necessarily be motivated to protect shareholder equity (and claims paying resources generally). Reinsurers will exert pressure too.**

Source: Insurance Information Institute

Exhibit 10

Total Value of Insured Coastal Exposure (2004, $ Billions)



Source: AIR Worldwide

PREPARED STATEMENT OF CHAD BERGINNIS, CFM

IMMEDIATE PAST CHAIR, STATE OF OHIO

OCTOBER 18, 2005

Introduction

The Association of State Floodplain Managers, Inc. (ASFPM), and its 21 Chapters represent over 8,000 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. Many of our members work with communities impacted by hurricanes Katrina and Rita or work with organizations that are assisting those communities in rebuilding. 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 programs and working to achieve effectiveness in meeting our shared objectives. Many of our members are designated by their governors to coordinate the National Flood Insurance Program (NFIP) and many others are involved in the administration of and participation in FEMA's mitigation programs. For more information on the Association, please visit *http://www.floods.org*.

The recent tragedies on most of the Gulf Coast, in Florida, and the emerging flood damage in the Northeast are reminders to the Nation that we are susceptible to hazards—especially flooding—and that we must have programs, policies, and institutions that can adequately handle these events, efficiently use taxpayer money, and build a more sustainable future. Nothing less than our Nation's prosperity and viability are at stake. The Congress and this Committee will be at the epicenter of this discussion, with an opportunity to make policy changes that can have importance and relevance far into the future. We would also like to recognize the tireless work and effort that thousands of FEMA employees have dedicated the current and past disasters. At this time, while we have critical debate and discussion on important policy issues, many FEMA staff are away from families and on extended deployment carrying out the important response, recovery, and mitigation programs of our Nation. While we continue to express our concern with FEMA being part of the Department of Homeland Security, the staff of FEMA is doing a tremendous job with the resources they have available.

Thank you for inviting us to offer our views on the solvency of the NFIP. The following testimony addresses:

- A Reflection on the Early History of the NFIP;
- The Impact on the NFIP from Expected Claim Payments from Hurricanes Katrina and Rita;
- The Desirability of Moving all Policy Premiums to Actuarially Sound Rates;
- Suggestions for Reducing Future Flood Damage and Flood Insurance Claims through Increased Mitigation;
- Recommendations for Increasing Voluntary Participation in the NFIP & Improving the Mandatory Purchase Requirements;
- Measures to Improve Effectiveness of Current NFIP Approaches;
- The Impact of FEMA's Reorganization on the NFIP.

A Reflection on the Early History of the NFIP

On August 1, 1968, Congress established the NFIP in enacting the Housing and Urban Development Act of 1968. According to Frank Thomas, a former NFIP official, the program cane into existence as a result of political compromises. Some urban interests wanted relief from property losses caused by recent urban riots in a number of major cities. Some rural interests wanted flood insurance to indemnify property owners from their losses. Without including urban property protection and reinsurance provisions in the act, the NFIP would not have been established at that time. In a retrospective view, the NFIP grew into a major national program and other provisions of the act never gained importance. Thomas characterized the NFIP as an accident that occurred from political tradeoffs that survives by every flood disaster.

The Act created the Federal Insurance Administration (FIA) within HUD to oversee the program. The program was established as a "quid-pro-quo" program. Through it, relief from the impacts of flood damages in the form of federally backed flood insurance became available to citizens in participating communities contingent on flood loss reduction measures embodied in State and local floodplain management regulations. Occupants of existing structures in floodprone areas would benefit from subsidized flood insurance premiums, but occupants of new structures would have to pay actuarially based premiums. This was based on the concept that those already living in the floodplain did not understand the flood risk involved in their locational decisions, but future occupants would through information provided by the NFIP—via flood studies and maps. The original program would be voluntary in terms of community participation and the purchase of flood insurance.

Congress tasked the FIA to carry out studies to determine local flood hazard areas within which flood insurance provisions and appropriate land use regulations would be applied. The FIA adopted the 1 percent annual chance as a minimum national standard for floodplain management, based upon a recommendation of a special review committee of national experts that met at the University of Chicago in December 1968.

By 1973, the NFIP had more than 3,000 communities participating. Despite this record, it became apparent that a truly "national" flood insurance program would not be achieved on a strictly volunteer basis, whereby localities could choose to join or not join and individuals could choose or not choose to purchase flood insurance coverage. Few incentives or requirements existed. Some form of penalty had to be applied to nonparticipating communities and their citizens to get participation. After a series of flood disasters struck the Nation in 1972, Congress again amended the National Flood Insurance Act of 1968 in 1973 to strengthen incentives for local participation. The Flood Disaster Protection Act of 1973 reaffirmed the use of the 1 percent annual chance flood and contained two major provisions. First, it prohibited Federal agencies from providing technical or financial assistance for acquisition or construction purposes in the designated floodplains of a community unless the community participated in the NFIP. This provision extended to financial institutions regulated or insured by the Federal Government, thereby covering virtually all types of financial assistance. Second, if a community participated, Federal agencies and federally regulated or insured lenders required flood insurance as a condition of grants and loans—giving birth to the "mandatory purchase" requirement. The 1973 Act greatly accelerated the number of communities participating in the NFIP and the number of flood insurance policies purchased. An chronology of major events affecting the NFIP can be found as part of the documents that are part of the nearly completed comprehensive evaluation of the NFIP that is being undertaken by the American Institutes for Research (see *http://www.fema.gov/nfip/nfipeval.shtm.*)

As history would reveal, the NFIP would ultimately have a profound impact in two important areas: Accelerating the identification of floodprone areas on maps and in providing incentives for States and communities to enact measures to regulate development in these identified areas.

The Impact on the NFIP from Expected Claim Payments from Hurricanes Katrina and Rita

The anticipated claims do not indicate a failure of the NFIP. Since the late 1980's the NFIP has been self-supporting, which largely means it covers all expenses and claim payments out of income from premiums and fees. Thus, the NFIP has not received direct U.S. taxpayer support for nearly two decades. Although the NFIP has authority to borrow from the U.S. Treasury when demand for claim payments exceeds reserves, it has always repaid its borrowing with interest. Now we face a situation where estimates of claims are around $22 billion. This comes on the heels of a significant number of claims from the four hurricanes that affected Florida last year. It is highly unlikely and unrealistic to expect that this surge in claims can be repaid. Instead, we should look to future programmatic changes that will reduce the number and impact of claim payments. Future policy changes could include anything from reinforcing the existing framework (such as expanding the policy pool), to changes in program regulations, to exploring the replacement of the NFIP with another program altogether—such as an all hazard insurance mechanism with strong hazard recognition, hazard management, and hazard mitigation elements.

Before we explore other policy options; however, we should reflect on some of the successes of the NFIP:

- Over 20,000 local jurisdictions recognize and manage their flood hazards by adopting flood hazard maps and administering floodplain management ordinances.
- Between 1978 and the end of 2004, the NFIP has paid $13.7 billion in losses that would otherwise have been paid by taxpayers through disaster assistance or borne by home and business owners themselves.
- The NFIP floodplain management standards have significantly reduced the frequency and severity of flood damages to buildings built in compliance with NFIP standards. Such structures experience 80 percent less damage than buildings that predate the standards.
- The NFIP floodplain management requirements are estimated to save around $1.5 billion per year in avoided flood damages.

It is also important to note that the first comprehensive evaluation of the NFIP is nearing completion. The multiyear study, conducted by the American Institutes of Research under a contract to FEMA, explores several significant issues such as the program's actuarial soundness, its developmental and environmental impacts, and compliance among participating communities with the NFIP's requirements. The evaluation's ultimate goal is to identify what works and what could be modified to improve the program's effectiveness. The evaluation's first study was released in March 2005 on the NFIP's mandatory purchase requirement. It is our understanding the study will be completed sometime within the next 12 months.

The Desirability of Moving All Policy Premiums to Actuarially Sound Rates

The 1968 Act separated the flood insurance ratemaking process into two distinct categories: Subsidized rates and actuarial rates. The rates for Pre-FIRM structures (constructed before a flood map was adopted) are subsidized. It is important to understand that the subsidy is actually a cross-subsidy within the program, and not a subsidy from the U.S. taxpayer. The rates for Post-FIRM structures (built after a flood map designated a property as within the floodplain) are actuarial. The original idea was that over the long-run the older buildings would reach the end of their design life and gradually be replaced by flood-resistant construction. In practice, this is taking longer than anticipated. Meanwhile, the expectation has grown that people who live in high-risk areas should pay based on their exposure to risk.

- The ASFPM believes that there are at least two ways to reduce the PreFIRM subsidy: (1) Mitigate Pre-FIRM structures (discussed in-depth in item D) by either eliminating the structure or turning it into a Post-FIRM compliant structure and (2) reduce or eliminate the Pre-FIRM subsidy for vacation homes, some rental properties, and other nonprimary residences.

Raising premiums to actuarial rates on all Pre-FIRM structures is not feasible and will likely be a hardship on many. According to FEMA's *NFIP Program Description (2002):*

> The long-term goal of the NFIP is to be actuarially sound, including consideration for potential catastrophic loss years. In the near-term, in establishing a fiscally sound program, the NFIP overall is intended to generate premium at least sufficient to cover expenses and losses relative to what is called the "historical average loss year." Since the NFIP's underwriting experience does not include truly catastrophic loss years, the historical average is less than the true long-term average.

It can be argued that losses in the last 2 years have encroached into the realm of "catastrophic." Those losses likely will drive a rate increase that will be difficult enough for home and business owners to absorb. However, moving some classes of structures toward actuarial rates may have merit. Some severe repetitive loss structures, based on the 2004 Flood Insurance Reform Act (2004 FIRA) will move toward actuarial rating but only after mitigation assistance is offered and if that mitigation offer is refused.

Suggestions for Reducing Future Flood Damage and Flood Insurance Claims Through Increased Mitigation

Mitigation is a set of techniques that can be used to reduce the risks to health and safety and reduce the future damage. Common mitigation techniques include acquiring/demolishing, elevating, relocating, retrofitting, or demolish/reconstruction of buildings. Since the 1988 Stafford Act amendments, mitigation has become one of the effective tools in reducing flood losses. Indeed ASFPM is eagerly anticipating a report on the benefits of mitigation that is currently under FEMA/DHS review and that is expected to show that mitigation techniques are very cost effective for the Federal Government, taxpayers, States, communities, and citizens.

Implementation of the 2004 Flood Insurance Reform Act (2004 FIRA). The premise of reducing the pre-FIRM subsidy through increased mitigation was part of the motivation behind both the 2004 FIRA and its predecessor act, the National Flood Insurance Reform Act of 1994. It was recognized repetitively flooded properties (repetitive loss) are a constant drain on the resources of the NFIP and that reducing the number of such properties would result in fewer claims—thus strengthening the financial standing of the program. Repetitive loss properties comprise about 50,000 of the NFIP's 4.5 million policies, yet represent nearly 30 percent of the dollars paid out. Of these properties, 83 percent are pre-FIRM. Nearly 10,000 of these properties have experienced four or more losses, or two or more loses which combine to exceed the building's value as reported on the flood insurance policy. The 2004 FIRA augmented the NFIP-funded mitigation grant program and created a pilot program focused on the repetitive loss problem.

Unfortunately, rules for implementation of the pilot program and the use of the demolition/rebuild option have not been written which is due, in a large part, to the extremely small number of staff in FEMA's mitigation program. Although 1 year of the 5-year program was lost without appropriations, the fiscal year 2006 Appropriations does include full funding for which we are appreciative for Congress' interest. Continued funding of these programs will have a positive impact on reducing the number of repetitive claims which will, in turn, enhance the financial stability of the NFIP.

- ASFPM urges the Committee to continue to support full funding for the Flood Mitigation Assistance and Pilot Program and to urge FEMA to expedite the writing of the rules for implementing the pilot program, including the rules allowing for the demolition/rebuild option.

Another important element of the 2004 Flood Insurance Reform Act included changes to the Increased Cost of Compliance (ICC) mitigation coverage that became part of the standard flood insurance policy after the National Flood Insurance Reform Act of 1994. However, as currently administered, it is being under-utilized. ASFPM supported the ICC reforms in the 2004 FIRA because of this under-utilization. Specifically:

- When paired with a mitigation grant for buyout, the ICC payment for demolition must be expanded to include all elements of demolition and lot restoration. Currently only certain costs associated with the primary structure are eligible.
- FEMA must direct adjusters to handle ICC claims congruent with the timeframe of mitigation grants to the maximum extent possible. This will be even more important as a result of the 2004 Reform Act which will increase the number of insured property owners undertaking mitigation who will also be eligible for the ICC payment.
- FEMA must not allow conflicts in determining which parts of mitigation projects are eligible under ICC and which are eligible under FEMA's grant programs. The two components must be made to work together and the claims adjuster and the mitigation manager must be in partnership focused on getting the funding invested in cost-effective mitigation measures.

The ICC claim payment can be used as the non-Federal match required by all of FEMA's grant programs and thus is an important component of making mitigation work. FEMA and its adjusters must make ICC work to get more buildings mitigated and to reduce future damage and claims.

- ASFPM suggests the Committee urge FEMA to make the necessary administrative changes to ICC promptly. This is absolutely necessary so that ICC can function effectively under all circumstances and specifically as directed by the 2004 Reform Act.

Support of FEMA's ongoing mitigation programs. Although not funded by the NFIP, FEMA's other ongoing mitigation programs authorized by the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Hazard Mitigation Grant Program and Pre-Disaster Mitigation Program) are important tools in mitigating pre-FIRM structures. While these programs are not focused exclusively on repetitive loss structures, they nonetheless largely address pre-FIRM flood prone structures. Why? Because these are the structures that usually suffer the greatest flood damage and, as a result, tend to have the most favorable benefit/cost calculations. However, in the last 3 years, there has been an effort to eliminate or reduce the HMGP, which is funded only after disasters. Unfortunately, the formula used to determine the HMGP amounts has been reduced from 15 percent to 7.5 percent, a reduction that greatly hampers mitigation in many states.

- ASFPM urges the Committee to express support for the restoration to the 15 percent basic formula for the HMGP.

Requiring mitigation in the Gulf Coast to be tied to advisory base flood elevations. In the aftermath of Katrina and Rita, FEMA quickly provided resources to update base flood elevations (BFE's—also known as 1 percent or 100-year) in the Gulf Coast region. These studies indicate that BFE's will increase several feet throughout the region. This is because when current hurricanes are added to previous records, the statistical analysis shows the elevation of the base flood is higher (the previously calculated flood levels were done years ago, in some cases over 25 years). However, advisory documents produced by FEMA only encourage the use of these advisory elevations for mitigation, rather than require their use when obtaining rants for mitigation. Mitigation done without using the advisory elevations is not sustainable and will have a direct impact on flood insurance—creating a subsidized rate for these structures that are to be rebuilt with Federal mitigation funds, as they will then be grandfathered at lower flood insurance rates when new flood maps are adopted in the future. This is an unwise use of taxpayer funds, and will impact the long term actuarial soundness of the NFIP.

- ASFPM suggests that the Committee urge FEMA to make the necessary changes to require that advisory base flood elevations be used for all mitigation projects in the Gulf Coast region and in future events.

Recommendations for Increasing Voluntary Participation in the NFIP & Improving the Mandatory Purchase Requirements

The mandatory purchase requirement of the NFIP has evolved through the years and is largely responsible for the number of flood insurance policies in-force today. The mandatory purchase requirement is implemented by federally regulated and federally insured mortgage lenders. The ASFPM believes that the purchase of flood insurance—whether voluntarily or required by lenders—can be improved and expanded as outlined below. Not only will property owners have increased awareness of flood hazards but also greater financial protection in the event of a catastrophic flood. Although increasing the number of flood insurance policies is important to the actuarial soundness of the program, it is arguably as important to the financial health of each individual and family who has purchased a policy to protect against future financial ruin.

Change the mandatory purchase requirement limits for property owners already in the 1 percent-annual chance floodplain. Although the current mandatory purchase requirement has had a positive effect, especially since passage of strengthening measures in 1994, there are still many issues and aspects of the process that make it less than effective. Current program regulations only require that a loan subject to the mandatory purchase requirement have flood insurance to cover the outstanding balance of the loan (protecting the lender's liability, not the owner's potential loss). Also, it is estimated that possibly up to 40 percent of new mortgages are not subject to mandatory purchase because they originate from unregulated lenders. A recent AIR study indicates this number may be much higher for manufactured homes which generally are financed by dealers. Finally, the loophole which allows a property owner to fill a site then file for an amendment to the community's flood map to eliminate the requirement to purchase insurance consumes significant FEMA resources and promotes significant filling in floodpain areas which in turn increases flood elevations on others. The ASFPM specifically recommends:

- Require those subject to the mandatory purchase requirement to insure to replacement value of the structure.
- Examine alternatives to require or encourage lenders not currently subject to the mandatory purchase requirement, and manufactured home dealers who make loans to require borrowers, to require their borrowers to obtain flood insurance.
- Reinstate the Section 202(b) in the 1973 Flood Disaster Protection Act that would prohibit regulated lenders from making, increasing, renewing, extending, or purchasing loans for improved real estate or manufactured homes in SFHA's in communities that do not participate in the NFIP.
- Direct FEMA to amend its regulations to eliminate or modify Letters of Map Revision based on Fill (LOMR–F) so that mandatory purchase of insurance is required.
- *Eliminate grandfathering of insurance premiums for structures built to elevations on the old map once a preliminary or advisory map is presented to the community.* In case of Preliminary FIRMS, communities sometimes stall adoption of the maps so that large tracts of land can be developed based on old elevations or in the absence of flood data. The result is all of these structures are built to lower flood elevations, and pay lower insurance premiums, and they continue to pay those lower, nonactuarial rates because they are "grandfathered." This grandfathering costs other policyholders to subsidize their insurance.

Change the mandatory purchase requirement to extend into areas beyond the 1 percent-annual chance floodplain. One of the lessons that can be learned from Katrina and other severe floods is that flooding is not confined to the areas shown on Flood Insurance Rate Map (FIRM) prepared by FEMA. Although the 1 percent floodplain was identified along the Gulf Coast, areas subject to lower probability flooding from major storm surges are not shown on the maps. In the case of Katrina, this resulted in a storm surge which extended miles inland destroying homes that had no flood insurance. Very few of these property owners had flood insurance because no flood hazard was identified for their property. The potential storm surge lines indicated a "residual risk" of flooding not shown on FEMA flood maps.

Across this Nation thousands of miles of levees and thousands of high hazard dams exist, yet the persons living in the "failure" areas behind those levees and below those dams are usually unaware they are in an area that will be flooded when those structures fail or overtop. Interestingly, areas that are protected by levees—provided that they are built to meet certain criteria—can be removed from the FEMA-mapped floodplain, with the implication that the areas have little or no flood risk. Furthermore, areas downstream of hazardous dams, the failure of which could cause catastrophic damage, are not identified as potential flood hazards on FEMA's FIRM's either. These areas have some commonalities—they are at risk from flooding, although the probability of such an event is much lower than a 1 percent chance. As we see in every dam break or levee failure, when such an event occurs catastrophic damage results. The ASFPM has long advocated the concept of mandatory "residual risk" flood insurance requirements for areas behind levees and floodwalls and below dams. The cost of such a policy would be commensurate with the lower risk of flooding, yet the property owner, states, communities, and the U.S. taxpayer won't be faced with bearing the costs of a catastrophic failure. The NFIP should map and require flood insurance in similar residual risk areas that are prone to storm surge from major hurricanes or in dam/levee failure zones.

- ASFPM urges the Committee to require that residual/catastrophic risk areas be identified and mapped on FEMA FIRM's and that the purchase of "residual risk" flood insurance be mandatory.

The National Flood Insurance Act as amended does not, in statute, identify a specification for any particular frequency of flood where flood insurance is required; rather it focuses on the need for flood insurance to be available. Such a policy change would support the intent of the Act.

Measures to Improve Effectiveness of Current NFIP Approaches

As stated earlier, the NFIP is a *quid pro quo* program. It relies on flood maps to identify flood hazard areas, and the adoption/enforcement of community development and land use standards to ensure new construction is flood resistant. In exchange for regulating flood hazard areas, flood insurance is available in that community.

In the wake of Katrina/Rita and other major flood events, it is logical to ask whether the regulatory basis, the 1 percent chance flood, is adequate. Recently, the ASFPM Foundation held the 2004 Gilbert F. White National Flood Policy Forum where this very topic was debated by 75 of the Nation's experts. The Forum concluded that the 1 percent chance flood standard, although in hindsight perhaps not a perfect choice, has nevertheless stood the test of many decades of use in a varied and changing nation. It was noted that there are areas in which specific scientific and technical knowledge are still lacking, and filling those gaps could help improve implementation.

Forum participants also observed that the Nation has changed and grown rapidly and that in some ways it has not been possible for the policies and practices associated with the 1 percent standard to keep pace. The Forum noted positive results, some apparent shortcomings in the standard and its use, and some broad approaches and specific actions that could be taken to help address deficiencies. Many of the Forum recommendations converge with ASFPM policy positions on improving the effectiveness of the current NFIP approaches.

First, it is important that we bring the 1 percent standard approach up to the 1 percent standard. In particular, this means we need to have an accurate portrayal of the 1 percent floodplain nationwide. There are gray areas of uncertainty surrounding the calculations and the mapped floodprone zone resulting from inadequate data, lack of consideration of changing and future conditions within watersheds, and oversimplified assumptions. Currently, FEMA is undertaking the Map Modernization program. The original vision of the program was to update the Nation's inventory of flood maps in terms of areas that still need to be mapped (where the 1 percent floodplain exists but is not yet identified), updating areas already mapped (1 percent flood may be higher due to watershed development), and updating the basic quality of the map so a floodplain does not appear to go 40 feet up a hillside. Additionally, it makes sense to convert all the maps into a Geographic Information System-based format to make future updates easier and create a seamless national flood layer. However, under current constraints, this vision will not be realized. The budget is too small, existing performance metrics of mapping so many communities in a period of time are driving the program in a way that results in less than adequate flood maps. It must be remembered that there is a legitimate national interest in mapping and as such, mapping partners at the State and local level, while contributing to enhance their basic inventory of flood maps, should not be viewed as a replacement for the national mapping program in terms of resources and overall responsibility. ASFPM continues to support partner contributions and delegation of mapping programs to qualified entities; however, just like EPA's Clean Water Act programs, the Federal Government should retain overall programmatic responsibility.

- The Committee is urged to support full funding for FEMA's Map Modernization program. ASFPM recommends that current funding levels be continued for a total of 10 to 15 years consistent with a total program cost of $2–$3 billion. Furthermore ASFPM urges the Committee to seek alignment of the performance metrics with such a funding level and timeline.

Another approach to improving the overall effectiveness of the NFIP is to enhance the existing 1 percent flood standard. Improvements could be made in the policies, regulations, and implementation of the 1 percent annual chance standard to make it more accurate and effective in achieving its goals. The National Flood Insurance Act, as amended simply outlines some performance measures for criteria. *The ASFPM recommends the following regulatory changes to the NFIP:*

- *Require floor elevations of new and substantially improved buildings to be at least 1 foot above the Base Flood Elevation.* Freeboard is a factor of safety that accounts for some uncertainty in our engineering methods, future upland development that increases runoff, and increases that are anticipated due to floodplain development. Additionally, construction with a freeboard results in significantly lower flood insurance premiums on the structure.
- *Require critical facilities and structural protective works be designed and constructed to achieve protection to the .2 percent annual chance flood (500-year).* Critical facilities are variously defined but generally include hospitals, police and fire stations, emergency operations centers, water/wastewater treatment facilities, and the like. Structural protective works, especially levees, provide a false sense of security. Those living behind levees think they will never flood, but the reality is different. When the levee fails or is overtopped (and they all will at some point in time), the damages are catastrophic and the human suffering is immense. No one has insurance, buildings are not elevated or protected at all. To ameliorate these impacts, structural works must provide protection to a higher level than buildings constructed in a floodplain where a flood event larger than the 1 percent may cause some flooding, but will not result in catastrophic damage.
- *Require new development to be constructed to advisory flood elevations when produced by FEMA after a significant flood event immediately after the advisory elevations are released if they are higher than existing base flood elevations.* In the Gulf Coast, it is expected that base flood elevations will rise significantly after the hurricanes of the last couple of decades. It would be foolish if new elevations were generated, but due to the regulatory process of FEMA that provides for public comment and input into the new elevations, that reconstruction would occur, protecting to a level far less than the new base flood elevation.
- *Conduct a review of how well Federal agencies comply with Executive Order 11988, Floodplain Management.* Issued in 1977, the purpose of this Order is to avoid Federal investment or assistance in floodplains unless there is no practicable alternative. Federal agencies that take actions that may impact floodplains (for example, construct facilities or provide funds or technical assistance to others to construct facilities) are required to have guidance or regulations for implementation. FEMA does not have any authority over how agencies implement E.O. 11988 and a critical review has never been done.

The Impact of FEMA's Reorganization on the NFIP

Prior to being reorganized in 2003, FEMA was already a lean organization. At the same time, it had built excellent relationships with States and communities; was able to quickly respond to disasters and decide on policy matters regarding its programs; had a true multihazard focus; and had developed a successful track record to accomplish its mission.

The ASFPM was concerned from the beginning that the inclusion of FEMA into DHS would not bode well for the progress the Nation has made in reducing our risk to natural hazards. Since the reorganization, there has been mounting evidence that our concerns have been realized. FEMA has gone from a small, independent agency with direct access to the President in times of major natural disasters to one of the Directorates in a huge organization. We have gone from "mitigation" being the cornerstone of the Nation's disaster programs to having the word nearly excised from the emergency management lexicon. Even though assurances were made that legacy missions of organizations would continue, terrorism was and is the primary focus of DHS. State and local emergency managers, especially those in areas prone to recurring natural hazards, are lamenting the "loss" of FEMA and are increasingly vocal about the need to restore FEMA to its previous state.

The following are specific concerns: Transferring FEMA funds to areas of DHS (the DHS Tax); use of policyholder funds for non-NFIP purposes; detailing FEMA staff out of that directorate; not filling vacant positions throughout FEMA, including senior leadership positions; and extensive delays in FEMA policy decisions and guidance due to an added layer of DHS bureaucracy. Over 200 FEMA staff positions are funded through the policy service fee income as part of flood insurance policy dollars, giving the Committee clear authority to focus on this issue.

- ASFPM urges the Committee to: (1) Monitor the FEMA/DHS issue to ensure that policyholder funds are not spent inappropriately, (2) that FEMA and NFIP priorities are carried out in order to protect the solvency of the fund, and (3) to support the restoration of a Presidentially appointed/Senate confirmed Flood Insurance Administrator.

In 2004, the ASFPM Board of Directors passed a resolution that FEMA should be taken out of DHS and reinstated as an independent agency.

Conclusion

The ASFPM originally formed as a result of the need to work with HUD and then FEMA on flooding and flood mapping issues. Today, we once again stand at a crossroads—in the aftermath of a catastrophic flood disaster with an opportunity to refine our Nation's policy for managing flood hazards. Thank you for the opportunity to provide our thoughts on these important issues. The ASFPM and its members look forward to working with you as we move toward a common goal of reducing flood losses.

PREPARED STATEMENT OF MARK J. BROWNE

GERALD D. STEPHENS CPCU CHAIR, RISK MANAGEMENT AND INSURANCE,
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OCTOBER 18, 2005

Thank you Chairman Shelby and Senator Sarbanes for giving me the opportunity to be here. My name is Mark Browne. I am the Gerald D. Stephens CPCU Chair in Risk Management and Insurance in the School of Business at the University of Wisconsin—Madison. Previously, I was on the faculty of The Terry College of Business at The University of Georgia. I received my doctorate in applied economics at the Wharton School of the University of Pennsylvania.

The National Flood Insurance Program, which began in 1968, is close to 40 years old. I think it is reasonable to expect that at least several catastrophic floods will occur in the United States over the next 40 years. The impact of these events on the affected areas, the finances of the government, and the economic health of the country will depend on the risk control and risk financing methods put in place prior to their occurrence.

When the National Flood Insurance Program was enacted it had three goals. One was to protect policyholders from the devastating financial consequences of flood damage. The second was to protect lenders from potential loan defaults resulting from flood losses. Third, and perhaps most important, was to protect the Federal revenue funds of the United States by collecting money from those exposed to flood loss prior to the occurrence of the loss.

In addition, the program serves other important purposes. It facilitates real estate transactions and thus promotes homeownership, which is a societal goal. It benefits the insurance industry as it relieves public pressure to provide flood insurance coverage. Finally, it is worth noting that the National Flood Insurance Program is popular in some parts of the country, although not as popular in other parts.

The flood peril presents an important threat to the property and well-being of a significant portion of the world's population. Like earthquake it has the potential to bring economic catastrophe and death to a broad geographic area. Also similar to earthquake, little coverage against the flood peril is available through the private insurance market. For example, homeowners insurance policies in Australia and the Netherlands exclude the flood peril, and in Germany flood coverage is seldom bought (*Business Insurance,* February 6, 1995). Although Graff (1999) reports that since 1991 roughly two-thirds of private insurers in Germany technically offer some coverage against flood, less than 10 percent of private property in that country is insured against damage from this peril. In the United States, individuals and small businesses wishing to purchase insurance against the flood peril typically obtain it through the National Flood Insurance Program.

The National Flood Insurance Program (NFIP) was established with the passage of the 1968 Housing and Urban Development Act (Vaughan, 1997). The NFIP is divided into two phases, emergency and regular. Under the emergency phase, a flood hazard map is provided and residents are allowed to purchase limited amounts of insurance at subsidized rates. Once a flood insurance map has been drawn that divides the community into specific zones with the probability of flooding determined for each zone, and the community has agreed to adopt more stringent mitigation and land use measures, it is allowed to enter the regular phase of the program (Rejda, 1998, pp. 155–156). In the early years of the program many communities were covered under the "emergency plan." Under that plan limits for single-family dwellings were capped at $35,000 (building)/$10,000 (contents) compared with $185,000 (building)/$60,000 (contents) under the regular plan.[1] By the early 1980's the number of communities that had qualified for the NFIP regular program had leveled off at about 18,000.

The rationale for a government sponsored flood insurance program arose from the apparent failure of the private insurance market. Possible reasons for the failure of the private market were offered in an American Insurance Association study that Anderson (1974) references, *Studies of Floods and Flood Damage, 1952–1955*. The study concludes that "insurance against flood cannot successfully be written" for several reasons. First, losses are a virtual certainty in some areas. Second, flood losses can be catastrophic in nature. Third, consumers are not willing to pay premiums that are sufficiently high to cover the loss exposure. Fourth, insurers are unable to pool insureds with varying degrees of exposure to flood losses because lower risks will not purchase coverage at a pooled rate.

While not mentioned in the American Insurance Association study an additional factor contributing to market failure may be a charity hazard. Charity hazard is the tendency of an individual at risk not to procure insurance or other risk financing as a result of a reliance on expected charity from others such as friends, family, community, nonprofit organizations, or a government emergency program.

The subsidized flood insurance available through the NFIP was intended to appeal to property owners who did not purchase insurance in the private market. The subsidized insurance is only made available in communities that adopt permanent land-use and control programs. Following adoption of these measures subsidized insurance is made available to residents but it is not extended to new construction. According to the U.S. General Accounting Office (GAO), in 1994 41 percent of NFIP policies were subsidized. Pasterick (1998) reports that the premiums paid on this group of subsidized policies are estimated to be less than 40 percent of the full-risk premium needed to fund losses expected in the long-run.

Loss statistics from two major storms inflicting flood damage in years following the creation of the NFIP indicate that significant amounts of property remain uninsured against the flood peril. Kunreuther (1984) reports that flood damage from Tropical Storm Agnes in June of 1972 exceeded $2 billion. Total damages paid by the NFIP were approximately $5 million. In 1993, the greatest single flood event in the United States occurred. Eleven million acres of farmland in the Midwest were inundated when the Mississippi River flooded, resulting in more than 50 deaths and causing $12 billion in total damages. Of the $12 billion in damages, less than $1 billion was covered by Federal flood insurance. Only about $600 million of the total was covered by private insurance, mostly through commercial difference-in-condition (DIC) policies.[2] While it is not yet known what the dollar value of losses from Hurricane Katrina will be, it is likely that the expenses of the NFIP will account for no more than 10 percent of the total.

Figure 1 shows by year both total flood damage and insured flood damage for the period 1983 through 1993. The figure indicates that the percentage of flood losses that are insured varies considerably from year to year and that for the decade as a whole a large portion of flood damage was uninsured. The variation in the level of insured flood losses per capita by year is presented in Figure 2.

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[1] The limits were raised in 1994 by the National Flood Insurance Reform Act.

[2] A program which is similar in many respects to the NFIP was established by the Federal Crop Insurance Act of 1980. The intent of this act was to replace Federal disaster assistance payments to farmers with Federal crop insurance. However, in 1993 participation levels even with an average premium subsidy of 30 percent were only about 35 percent of eligible acres (Barnett and Skees, 1995).

Figure 1

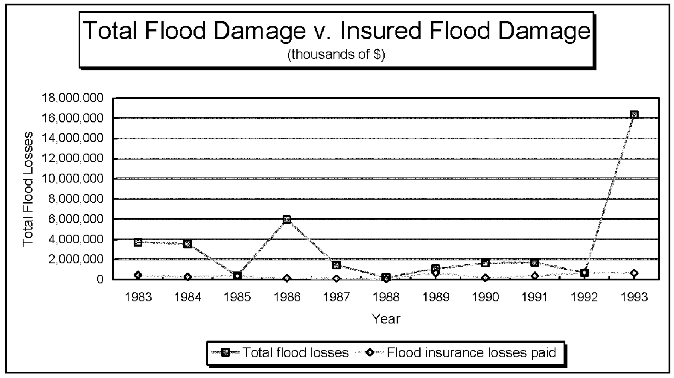
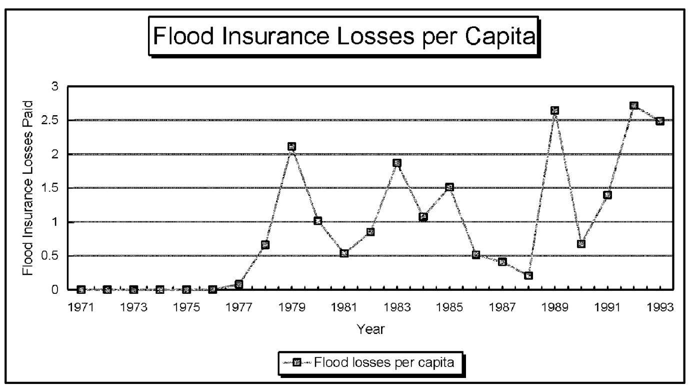


Figure 2



Various explanations have been offered for why the NFIP does not insure a larger portion of flood losses. Kunreuther (1984) provides several possible reasons for individuals' failure to purchase flood insurance. These include the perception by some that the flood peril is less threatening to their property than it actually is. Individuals may underestimate the probability that they will suffer flood damage as a result of having little or no past experience with the peril. Others are unaware that they can purchase flood insurance coverage. Another possible explanation is that consumers feel the price of flood insurance, even when subsidized, is still too expensive. Additionally, Lewis and Nickerson (1989) posit a model for expenditures to mitigate the effects of natural disasters when individuals are partially insured against financial loss by a public relief program (for example, disaster loans, grants, etc.). Their model suggests that underinvestment in loss mitigation and insurance, that is, reduced incentives to spend personal resources on loss mitigation and insurance, are a consequence of the limited liability provided by government programs of disaster relief.

To understand the low rates of flood insurance purchase, it is important first to consider demand for insurance in general. Theory underpinning the demand for insurance has received considerable scholarly attention. An extensive review goes beyond the aims of this discussion, but a cursory review of some of the major work in this area is of value. As both individuals and businesses purchase flood insurance, we consider the factors motivating the purchase of insurance by each.

The Demand for Insurance by Individuals

Smith's (1968) theoretical model of the demand for property insurance by individuals implicitly assumes that individuals are able to form correct estimates of the probabilities associated with all possible loss outcomes. In his analysis, factors which are important determinants of insurance consumption include wealth, the probability of loss, the price of insurance, the value of the item exposed to risk, and the utility function of the individual considering the purchase of insurance. Smith finds that when the price of insurance per dollar of coverage is less than one and the probability of no loss is greater than zero the optimal insurance purchasing decision may entail either purchasing or not purchasing coverage. In this context, self-insuring may be optimal. Other things equal, self-insurance will be optimal the less risk-averse an individual is and the greater the probability of loss. Self-insurance will also be optimal the greater one's wealth, assuming the individual's utility function is characterized by decreasing absolute risk aversion. Given a particular price of insurance, utility maximization suggests that an individual is more likely to self-insure the lower the probability of loss. In contrast, given a fixed probability of loss an individual is more likely to insure the lower the price of insurance. Insurance purchases are also theorized to be positively linked to the value of the item at risk, other things equal.

As mentioned above, the probability of loss parameter in Smith's model is assumed known to both insureds and insurers. This assumption is frequently made by researchers who model the demand for insurance. See for instance, Raviv (1979), Mossin (1968), Borch (1960), and Gould (1969). The adverse selection literature is based on the assumption that insureds form more accurate estimates of the probability of loss parameter than insurers. See for instance, Rothschild and Stiglitz (1976), Wilson (1977), and Miyazaki (1977). These models, while leading to different results in some aspects, all find that low risk insureds will purchase less insurance in a market with adverse selection than in a market free of adverse selection.

In contrast to the adverse selection literature which posits that insureds are better informed about their actual probability of loss than insurance companies, Kunreuther's (1984) contention, that property owners may not purchase flood insurance because they underestimate their true probability of loss, suggests just the opposite. Kunreuther's suggestion points to a possible second difference between the flood insurance market and those insurance markets characterized by adverse selection. In the adverse selection literature the market is composed of high risk and low risk insureds, each with different probabilities of loss. The high risks estimate that their probability of loss exceeds the insurance company's estimate. The low risks perceive that their probability of loss is less than that estimated for them by the insurance company. In the case of flood insurance, Kunreuther's suggestion is that without distinction to risk class insureds underestimate their loss probability. From the perspective of an individual who underestimates the true probability of loss and must make the decision whether or not to purchase insurance as modeled by Smith, the price of insurance quoted by the insurer would seem high. If the insured underestimates the actual loss probability, subsidized insurance rates may even seem expensive.

An alternative, or in some cases complement, to insurance is an investment in reducing the likelihood or severity of the loss. The Federal Government makes considerable investments each year in flood loss mitigation. Although mitigation can reduce the probability and severity of flood losses, it may also produce a sense of security which results in further development in floodplains and reduces the perceived value of flood insurance (Pasterick, 1998, p. 125). We do not have direct information on how finely NFIP reflects changes in flood risk in its premium pricing structure. However, the continued high level of subsidy in the program suggests that prices are unlikely to fully reflect changes in risk resulting from mitigation. If this is the case, then increased expenditures on mitigation would decrease the demand for flood insurance. Additionally, Pynn and Ljung (1999) surveyed residents in Grand Forks after the severe flooding in 1997 and asked them to evaluate the importance of 18 factors in influencing their decision not to purchase flood insurance. The respondents ranked as number 2, "I believed the dikes and other flood control devices would protect me from experiencing flood damage." Number 1 was the "National Weather Service did not predict the river to crest so high." This result provides a rather compelling argument for the expectation of a negative relation between mitigation and flood insurance demand.

Finally, to the extent that individuals expect to be eligible for other forms of disaster assistance after suffering flood losses, their incentives to purchase Federal flood insurance will be reduced. This assistance could come in the form of disaster loans, grants, and other aid.

The Demand for Flood Insurance by Businesses

The National Flood Insurance Program makes insurance available to businesses as well as individuals. Since businesses do not have utility functions, standard utility maximization arguments do not provide an explanation for their purchase of insurance. Mayers and Smith (1982) argue that profit maximization provides a rationale for the purchase of insurance by businesses. They contend that the purchase of insurance may result in greater profitability if it leads to more favorable terms in a variety of different transactions. Examples include lower interest rates on debt, and better relationships with suppliers, buyers, and employees. The business's decision to purchase insurance coverage therefore depends not on its own utility function but that of the parties with which it enters into different transactions.

While the economic rationale for purchasing insurance is different for businesses than it is for individuals, the same set of factors are important—price, the probability of loss, the amount of loss. In the case of a business, the income, wealth, and shape of the utility functions of parties to transactions are determinants of insurance purchases. Just as in the case of demand for flood insurance by individuals, an incorrect estimate of the probability of loss may result in the business choosing not to purchase flood insurance.

A colleague of mine, Dr. Robert E. Hoyt of the Terry College of Business at the University of Georgia, and I used data supplied by the National Flood Insurance Program to study what factors influence individuals' and businesses' purchase of flood insurance. We found that income is positively related to the amount of flood insurance purchased. Individuals with greater financial resources are more likely to take advantage of the Government's flood insurance program. An important question that could be raised is whether or not insurance is the best approach to providing disaster protection to the low-income segment of the population. The low levels of participation in the NFIP and our finding that income matters suggest that perhaps this is not the best approach.

Our empirical results indicated that the price of flood insurance, measured as written premiums per $1,000 of flood insurance in force in the State, is negatively correlated with flood insurance purchases. Our analysis suggests that if the Government decreased the price it charges for flood insurance, more insurance policies would be sold and the amount of flood insurance in force would increase. However, the demand for additional policies is relatively price inelastic.

Our study provided evidence consistent with Kunreuther's (1990) hypothesis that risk perceptions influence insurance purchasing behavior and Viscusi's (1991) Bayesian learning model. We found that the number of flood insurance policies sold during a period is positively correlated with flood losses during the prior period. Similarly, Palm et al. (1990) report that surveys taken of property owners before and after the Loma Prieta earthquake of 1989 revealed that the percent of respondents who felt earthquake insurance was unnecessary after the earthquake was significantly less than the number who held that belief before the earthquake. If, as our evidence and that of others indicates, perceptions of the risk of flood loss are an important determinant of insurance purchases, informational materials directed at increasing the public's awareness of the danger posed by the flood peril may be an effective means of increasing the purchase of flood insurance.

Our study used economic data to explore the reasons why individuals purchase flood insurance. A number of interesting questions that we were not able to address await future research. We know relatively little about how people form estimates of the likelihood of suffering flood damage. The relationship between the recent occurrence of flood damage and the decision to purchase coverage emerges in our data analysis. While it is plausible that the Government could increase sales of flood insurance by modifying individuals' perceptions of potential loss, how this could be best done and the cost are open questions. Similarly, as mentioned above, our analysis supports the hypotheses that income and price are important determinants in the flood insurance purchasing decision. This suggests that vouchers to purchase flood insurance may be an effective means of increasing coverage. Analysis of household level data likely would yield more accurate estimates of price and income elasticities than we were able to derive. Such an analysis would help to determine what the potential costs of increasing participation in the flood insurance program through a voucher program would be.

Our data showed that a large portion of flood losses is not insured by the National Flood Insurance Program. Information on how individuals do pay for flood losses may shed light on why individuals choose not to purchase flood insurance.

A final point to consider is that the FHA requires the purchase of flood insurance by those seeking FHA-backed mortgages in flood zones. This requirement serves as a powerful incentive for the purchase of flood insurance. Other things equal this requirement will result in increased purchases of flood insurance. We included the number of FHA mortgages per 1,000 population in our analysis to control for this effect. As FHA-backed mortgages and flood insurance are essentially complimentary goods as a result of the FHA's requirement, we hypothesized a positive relationship between the two. Kunreuther (1996) has questioned whether FHA requirements are easily avoided. He cites a study by the GAO (1990) that reports that 79 percent of victims of a major flood in Texas in 1989 that were required to purchase flood insurance were not insured. The implication he makes is that it would not be surprising if many of these individuals bought flood insurance when they received their mortgage and later dropped the coverage.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM DAVID I. MAURSTAD

Properties Protected by Dams and Levees

Q.1. *A Washington Post* article entitled "Risk Estimate Led to Few Flood Policies" published on October 17, 2005, details how many residents of the destroyed Ninth Ward in New Orleans were not in mandatory purchase areas for flood insurance purposes. The article says the following ". . . Federal insurance maps, however, were based on a vastly mistaken assumption: That the levees and flood walls protecting the neighborhood from inundation would remain intact. When the levees breached near the Lower Ninth, the floodwaters ravaged countless homes unprotected by flood insurance, and many neighbors wonder whether anyone will have the wherewithal to rebuild." As I understand it, areas protected by levees and dams are not mapped as being in the 100-year flood zones. Do you have any data on the amount of flooding that takes place in areas protected by levees and dams? If so, please provide such data to the Committee. What is your position on whether properties in these areas should be required to carry flood insurance?

A.1. FEMA does not currently assess dam failure as part of the National Flood Insurance Program (NFIP).

In many cases, the U.S. Army Corps of Engineers (USACE) is responsible for designing, constructing, operating, maintaining, and providing certification for levee systems. FEMA's role is to provide guidance criteria for the recognition of levees on Flood Insurance Rate Maps (FIRM's). If the USACE certifies a levee to the minimum standard of providing protection from the base flood (also known as the 1 percent annual chance flood or the 100-year flood), FEMA will recognize it on the FIRM.

FEMA does not have specific data concerning the amount of flooding that has occurred for properties protected by levees, because most land areas protected by levees are not identified with unique FIRM zone designations by which flood insurance claims are tracked.

The current mapping standards require the establishment of a residual flood risk zone in areas protected by levees from the 100-year flood. Such areas are considered to be in the 0.2 percent annual chance floodplain (also known as the 500-year floodplain) and at moderate risk of flooding. The 500-year floodplain is designated on the FIRMs as shaded Zone X. Currently, Federal mandatory purchase requirements do not extend to buildings located in areas with this designation. However, language on the body of the map notifies communities and homeowners about the potential risk in these areas.

In his January 25, 2006, oral testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, David I. Maurstad, Acting Mitigation Division Director and Federal Insurance Administrator for FEMA, recommended that Congress should direct FEMA to study the feasibility and implications of expanding the standard for mandatory purchase requirement to include the 0.2 percent chance per year floodplain (500-year floodplain) and properties in areas of residual risk (areas protected by levees, dams, and other manmade structures).

Map Modernization Project

Q.2.a. I understand that FEMA is in the midst of a flood map modernization project. Clearly, it is critical that flood maps accurately reflect flood risks. Please provide a detailed update on where FEMA is in its map modernization project, as well as a timetable for completion.

A.2.a. The flood map modernization initiative is anticipated to be funded through fiscal year 2008 with mapping activities continuing through 2010. The planned mapping activities for fiscal years 2006 through 2008 are contained in the FEMA Multi-Year Flood Hazard Identification Plan (MHIP) Version 1.5, dated June 2005. The plan is available on FEMA's website at *http://www.fema.gov/fhm/mh_main.shtm.*

At the end of fiscal year 2005, the following progress had been achieved:

- Digital flood map products are available for thirty-nine (39) percent of the Nation's population.
- Digital flood map products cover fifteen (15) percent of the land area of the continental United States.

Q.2.b. I am concerned that FEMA may not have the staffing or resources to update all flood maps. GAO found in March 2004 that although 75 staff were needed to monitor and manage the map modernization process, only one additional staff person had been hired, and there were plans to transfer 43 staff to the project. Please provide to the Committee the number of staff allocated to the map modernization project as well as the number of staff transferred from other FEMA offices, including which offices staff were moved away from.

A.2.b. In addition to the 99 existing personnel, FEMA has allocated 43 additional full time personnel to Map Modernization at FEMA headquarters and the 10 FEMA regions. Additionally, the FEMA-contracted National Service Provider, known as the Mapping On Demand Team, has established regional management centers at each regional office to assist in the production and management of flood mapping. There is also a system of contract support in place at FEMA headquarters and the regional offices which provides administrative and professional support to the map modernization effort. As part of its fiscal year 2006 mid-course review, FEMA is undertaking a staffing analysis for the map modernization program and will reevaluate resource needs.

Q.2.c. Please provide the Committee with the estimate of needed resources for the map modernization project over the next 5 years.

A.2.c. The existing life cycle model for the Flood Map Modernization Program as currently requested for the next 5 years, fiscal year 2007 through fiscal year 2011 in the Future Years Homeland Security Plan (FYHSP), is as follows:

Flood Map Modernization
(in Millions)

Appropriations				FYHSP FY07–FY11					FYHSP Total
FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY07–FY11
$150.0	$200.0	$200.0	$200.0	$201.2	$202.7	$204.5	$204.9	$205.3	$1,018.60

GAO Report

Q.3. GAO recently found that FEMA's quality assurance reinspections which are done to review Write Your Own companies were not being done correctly. GAO found that FEMA's approach "does not provide management with the information needed to assess the overall performance of the write-your-own companies, including the overall accuracy of the underwriting of NFIP policies and the adjustment of claims-information that FEMA needs to have reasonable assurance that program objectives are being achieved." Please detail FEMA's plans to address this deficiency.

A.3. As noted in Mr. Maurstad's response to the October 2005 GAO report, "Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program," FEMA vigorously disagrees with the conclusion of the report concerning its oversight of the Write Your Own (WYO) insurance companies. The following is a quote from Mr. Maurstad's letter dated October 12, 2005:

> The GAO has given prominence to a concern that is not the main issue and is based on only partial review of Program controls. With its report title and "highlights" section GAO has chosen to emphasize a rather arcane recommendation with regard to statistical sampling without noting, as the report itself states on Page 5 that "the processes that FEMA had in place for operational reviews and quality assurance reinspections of claims adjustments met our internal control standard for monitoring Federal programs" and later on Page 21 that "The processes FEMA followed also met our internal control monitoring standard that requires Federal agencies ensure that the findings of audits and other reviews are promptly resolved." Further, the report does not put operational reviews and reinspections in the appropriate context within the entirety of what FEMA does to provide oversight of the NFIP and Write Your Own (WYO) Companies. It is misleading to characterize the operational reviews as "FEMA's primary method to monitor and oversee the NFIP" (Page 27). While very important, these operational reviews, as well as the claims reinspections, are only parts of a comprehensive Financial Control Plan that has effectively provided oversight and control of the WYO insurance operations of the NFIP as discussed below. Biennial audits by CPA firms, annual Inspector General financial audits, monthly editing of policy and claims transactions along with the statistical and financial reconciliations provide an abundant amount of random sampling and thorough review of WYO transactions. This information does not appear to have been considered by the GAO in its study. However, these monitoring and control mechanisms do have a bearing on the design and use of operational reviews and claims reinspections. It is difficult to understand how the GAO can reach a conclusion that FEMA is not meeting an internal control standard without a consideration of all the controls and processes that FEMA has in place to provide oversight of the Program.

FEMA feels that the appropriate controls are in place to supervise the WYO insurance companies. Furthermore, remedial actions in that area would be an unwise use of scarce resources given the large number of higher priority projects currently under consideration and in process.

Repetitive Loss Properties

Q.4.a. According to CRS, as of December 31, 2004, FEMA had identified 11,706 properties which had severe repetitive losses. Please detail what FEMA is doing to mitigate the flood losses on these properties.

A.4.a. FEMA defines Repetitive Loss properties as structures for which two National Flood Insurance Program (NFIP) policy claims in excess of $1,000 have been paid, within any rolling 10-year period. As of November 30, 2005, there are over 63,000 currently insured locations meeting this definition.

The Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (Public Law 108–264) created a subset of the Repetitive Loss properties through the establishment of the Severe Repetitive Loss properties, which the Act defines as follows:

> ''(b) SEVERE REPETITIVE LOSS PROPERTY.—For purposes of this section, the term 'severe repetitive loss property' has the following meaning:
>
> ''(1) SINGLE-FAMILY PROPERTIES.—In the case of a property consisting of 1 to 4 residences, such term means a property that—
>
> ''(A) is covered under a contract for flood insurance made available under this title; and
>
> ''(B) has incurred flood-related damage—
>
> ''(i) for which 4 or more separate claims payments have been made under flood insurance coverage under this title, with the amount of each such claim exceeding $5,000, and with the cumulative amount of such claims payments exceeding $20,000; or
>
> ''(ii) for which at least 2 separate claims payments have been made under such coverage, with the cumulative amount of such claims exceeding the value of the property.
>
> ''(2) MULTIFAMILY PROPERTIES.—In the case of a property consisting of 5 or more residences, such term shall have such meaning as the Director shall by regulation provide.

As of December 31, 2005, the number of structures meeting the Severe Repetitive Loss (SRL) definition as provided for in the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 is estimated to be over 7,700 structures. Of this total, 4,849 structures have been verified to be SRL properties.

FEMA has addressed repetitive flooding on many fronts: flood hazard mapping, floodplain management regulations, insurance, mitigation, and public information. Some examples follow:

- FEMA has made repetitive flooding an important factor for determining the scope of our floodplain mapping efforts under its Multihazard Flood Map Modernization Program. Areas of repetitive losses outside existing floodplains are being studied for possible remapping, and communities with large numbers of repetitive loss properties are receiving special attention.
- FEMA has provided guidance documents, new software, and training to assist local officials in making substantial damage determinations, which requires properties to meet local codes when rebuilding.
- FEMA has increased the coverage available under Increased Cost of Compliance (ICC), the additional flood insurance coverage that can help pay for code-mandated mitigation projects after a flood. The triggers for ICC coverage are being liberalized in accordance with the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004.
- FEMA has identified the most egregious repetitively flooded properties and transferred their flood insurance policies to the Special Direct Facility (SDF), directly administered by the NFIP. This allows FEMA to directly communicate with the policy holders and to closely monitor claims when they are adjusted.

- FEMA has made repetitive loss properties a national priority for our mitigation grant programs. Over the past 10 years, FEMA has spent over $320 million to acquire, elevate, or otherwise protect repetitively flooded structures.
- FEMA has developed new technical publications and guidance for property owners and State and local officials on how they can better protect themselves and their communities.
- Each of FEMA's 10 Regional offices has designated a Repetitive Loss Coordinator who is working with their states and communities to develop new approaches to and techniques for mitigating repetitive loss properties.
- To date, approximately 8,600 of the repetitively flooded properties that FEMA has identified are known to have been mitigated. FEMA provided ICC and mitigation grant funds for roughly one-half of these projects.
- In addition to the original mandatory requirements for Community Rating System communities to identify and in many cases plan for any existing repetitive loss problem, additional credit points were added to those activities that encourage the mitigation of repetitive loss areas and individual repetitive loss properties.
- The Flood Insurance Reform Act of 2004 (FIRA 04) authorized a Severe Repetitive Loss Pilot Program.µ Congress authorized $40 million to be transferred from the National Flood Insurance Fund as part of FEMA's fiscal year 2006 appropriation to implement this program. FEMA is currently developing regulations and expects to begin to allocate funds during late fiscal year 2006.
- FIRA 04 also authorized $10 million for the Repetitive Flood Claims (RFC) Program to mitigate properties that have at least one flood claim. RFC Program guidance is currently being finalized, and all funds are expected to be awarded during fiscal year 2006.

Q.4.b. Please provide data on the location of these properties by State, as well as breakdown of pre and post FIRM repetitive loss properties nationwide and by State.

A.4.b. Please see the attached table.

Second or Vacation Homes Insured under the NFIP

Q.5. Please provide data to the Committee on the number of properties which have flood insurance policies with NFIP which are second or vacation homes. Please provide this information on a nationwide basis, as well as by State. In addition, please provide data on the number of these second or vacation homes which are pre-FIRM on a nationwide basis, as well as by State.

A.5. Please see the attached table. The table presents data about "Principal residences" and "Other than principal residences" within the category "Single family residences" as of August 31, 2005. "Single family residences" are single family houses and condominium units. Under the Standard Flood Insurance Policy (SFIP) a "principal residence" is defined as the one in which the insured resides at least 80 percent of the time. The "other than principal residence" category includes vacation, second, and rental homes of the insured.

Mandatory Purchase Requirements

Q.6. Please provide any data or information FEMA has on compliance with the mandatory purchase requirements.

A.6. Past research on compliance with the mandatory purchase requirement has been completed by the Government Accountability Office (GAO), RAND Corporation, and the American Institutes for Research.

The research indicated that approximately 50 to 60 percent of single family homes in Special Flood Hazard Areas are subject to the mandatory purchase requirement. Estimates suggest a Nationwide compliance rate of 75 to 80 percent, with an 80 to 90 percent compliance rate in the South and West and 45 to 50 percent in the Northeast and Midwest.

For more information, the completed studies are available on FEMA's website at:

http://www.fema.gov/pdf/nfip/market_pen.pdf.
http://www.fema.gov/pdf/nfip/mandpurch_0305.pdf.
http://161.203.16.4/d23t8/142248.pdf.

Written Statement
of the
NATIONAL ASSOCIATION OF REALTORS®
submitted to the
Senate Banking Committee
On
"National Flood Insurance Program"
October 18, 2005

It is often said that REALTORS® don't sell homes, we sell communities. The members of the NATIONAL ASSOCIATION OF REALTORS® are concerned and active members of our communities. We recognize and support the important role that the National Flood Insurance Program plays in managing the risk of flooding which affects so many of our communities.

The NFIP is a unique partnership between our three levels of government. It enables property owners in participating communities to purchase insurance as a protection against flood losses in exchange for State and community floodplain management regulations that reduce future flood damages. As a result, federal expenditures for disaster assistance and flood control are reduced.

The National Flood Insurance Program partners with over 20,000 communities to reduce flooding nationwide and holds 4.6 million policies representing $743 billion in insurance coverage. It provides over 90% of all flood insurance nationwide and close to 100% of flood insurance coverage for individually-owned properties and small- to mid-size commercial properties. Ninety-one insurance companies write flood insurance, either under the Write Your Own program or through direct sales. In FY 2004, the program generated nearly $ 2 billion in written premiums, with premiums averaging $400 per year. NFIP participants are eligible for up to $250,000 in building coverage and up to $100,000 in coverage for personal property. By providing affordable flood insurance that is unavailable in the private market, the NFIP helps our citizens achieve the American dream of homeownership.

Congress has been working to address the updating of FEMA's Flood Insurance Rate Maps. Flood maps determine whether a property is located in a floodplain, and thus whether flood insurance is required in order to secure a mortgage. When maps are inaccurate, properties incorrectly included in a floodplain are unnecessarily required to have flood insurance coverage. Similarly, properties incorrectly excluded from a floodplain are exposed to flood risk without the benefit of insurance coverage. During a property transaction, correction of an inadvertent inclusion - through FEMA's Letter of Map Amendment process - adds unnecessary cost and delay to the transaction.

Flood maps serve a number of other important functions. The National Oceanographic and Atmospheric Administration estimates that the cost of flood damage in the 1990s exceeded $5 billion annually, with an average of 100 deaths per year due to flooding. To limit the costly impact of floods, flood maps help communities develop flood management strategies, implement more effective land use and building codes, develop disaster preparedness plans, and incorporate disaster planning into regional economic development strategies.

FEMA plans to modernize its floodplain maps by replacing the existing paper maps with computerized maps that are more accurate, more accessible, and easier to keep current. FEMA's map modernization program goes beyond simple replacement of paper maps with digital ones. Digital technology will allow FEMA to collect new and better data.

NAR was pleased that the House and Senate have recognized the importance of accurate and dependable floodplain maps and have proposed providing FEMA with $200 million in FY 2006 to continue its map modernization program. However, more funds are needed to complete this modernization. For FY 2007, FEMA will require additional funds to continue its map modernization program. We strongly encourage Congress to appropriate the full amount requested so that FEMA can complete this important project as soon as possible.

NAR commends the members of this Subcommittee – especially Chairman Ney (R-OH), Ranking Member Waters (D-CA), and Rep. Brown-Waite (R-FL), who joined with Capital Markets Subcommittee Chairman Baker to offer H.R. 3669, the "Flood Insurance Program Enhanced Borrowing Authority Act of 2005". The NFIP is a unique partnership among three levels of government. It enables property owners in participating communities to purchase insurance as a protection against flood losses in exchange for State and community floodplain management regulations that reduce future flood damages. As a result, federal expenditures for disaster assistance and flood control are reduced. This bill, which has been signed into law, temporarily increased the National Flood Insurance Program's borrowing authority to pay claims after the devastating tragedies of Hurricane Katrina.

In addition, NAR commends Rep. Richard Baker (R-LA) and the Congress for passage of H.R. 804, the "Flood Insurance Clarification Bill". This bill amends the National Flood Insurance Act of 1968 to declare that assistance provided under a program for flood mitigation activities with respect to a property shall not be considered income or a resource of the owner of the property when determining eligibility for or benefit levels under any income assistance or resource-tested program that is funded in whole or in part by a federal agency or by appropriated federal funds. This law will help many citizens of the affected areas begin to rebuild their homes, without worrying about the tax implications of assistance they receive.

NAR believes the time is right to renew Congressional discussion over natural disaster relief insurance. The inability to obtain affordable homeowners' insurance is a serious threat to the residential real estate market – and thus, our economy, in several ways. Since homeowners' insurance is a necessary component in securing a federally-related mortgage, an otherwise creditworthy potential homebuyer who cannot obtain the required insurance is priced out of the market. If an existing homeowner is unable to maintain insurance required by a mortgage lender, the mortgage is in default. In lease situations, insurance costs incurred by landlords are ultimately passed along to tenants in the form of higher rents. Consequently, NAR supports the creation of a federal natural disaster program with the goal of preventing future disruptions in the insurance market and promoting available and affordable homeowners' insurance in disaster-prone areas.

Rep. Brown-Waite (R-FL) and her fellow Floridian, Rep. Davis (D-FL), have introduced H.R. 846, the "Homeowners' Insurance Availability Act". This bill would establish a federal program, administered by the U.S. Treasury Department, making reinsurance coverage available in order to improve the availability of homeowners' insurance. Treasury would offer reinsurance contracts for sale, through regional auctions conducted at least once a year, to private insurers and reinsurers, state insurance and reinsurance programs, and other interested entities. NAR supports this legislation because it facilitates a solution to the disaster insurance crisis by promoting the availability and affordability of homeowners' insurance in disaster-prone areas. The bill provides a temporary, limited federal backstop for the private insurance and reinsurance industries. By spreading the risk of large catastrophes and preventing future disruptions in the insurance market, the proposed federal reinsurance program is well designed to make homeowners' insurance more available and affordable. It supplements rather than supplants the private market, and it contains adequate safeguards to protect the federal treasury. As Louisiana, Mississippi and Alabama strive to rebuild, a program of this type could assure that homeowners' insurance is available and affordable to residents who wish to continue living in their communities.

Equally of note, Rep. Mark Foley (R-FL) has introduced H.R. 2668, the "Policyholder Disaster Protection Act," which would allow insurance companies to create reserve funds from pre-tax dollars in order to pay claims arising from future major natural disasters. This could help to protect insurance companies from devastating claims (like the ones they will face with Katrina) and allow them to continue to provide insurance in devastated areas.

NAR believes the National Flood Insurance Program is a critical tool to manage flood risk across our nation's communities. However, we believe the time is right for Congress to look at the big picture. Flooding is a very serious threat in many areas of our nation, but there are other disasters that are just as critical. While state programs and the private insurance industry have tried to handle disaster insurance on their own, they simply do not have the capacity to cover the risk presented by mega-catastrophes. A federal natural disaster program is needed to prevent future disruptions in the insurance market and promote available and affordable homeowners' insurance in disaster-prone areas. We urge Congress to take a serious look at the creation of a program that can spread the risk of large catastrophes and protect homeowners and our economy in the long term.

PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

WEDNESDAY, JANUARY 25, 2006

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

This morning, the hearing meets to hold its second hearing on the future of the National Flood Insurance Program. Congress established the National Flood Insurance Program pursuant to the National Flood Insurance Act of 1968, to provide policyholders with some insurance for flood-related damage, require mitigation efforts to limit such damage, and generate enough revenue through premium dollars to prevent taxpayers from paying for disaster-related assistance due to flooding.

Over the course of its near 40-year history, this program has never approached actuarial soundness, which can be directly attributed to the manner in which the program was designed. This design failure was fully brought to bear by the recent hurricanes, and the program now stands bankrupt.

Current estimates demonstrate that FEMA will pay out at least $23 billion in flood insurance claims for Hurricanes Katrina, Rita, and Wilma. This will surpass all combined previous payments from the National Flood Insurance Program's 30-year history. FEMA's current borrowing limit it $18½ billion, which was raised from $3.5 billion in mid-November. Congress will need to raise this limit again in the coming month.

Under the present structure, assuming no major floods, it would take FEMA decades or more to repay the U.S. Treasury the amount it borrowed for Katrina-related claims alone. We cannot, however, assume that there will be no major floods. To the contrary, the National Hurricane Center has indicated that intense storms are likely to continue for many years. We, thus, face the considerable challenge of closely scrutinizing every aspect of the program to determine how to restructure it to put it in a sustainable working order.

One of the major problems with the program is its rate structure. As much as a quarter of all properties pay explicitly and massively subsidized rates. Hundreds of thousands of additional program participants receive indirect subsidies. There are also deficiencies in the mapping used to establish the pricing levels for covered properties. All told, the subsidies have drained billions of dollars from the program, leaving it financially incapable of meeting its true responsibilities.

But compounding these deficiencies, the program has directly affected the willingness to take financial risk. Where, prior to the program, there were areas where construction did not occur because
financing was not available for it, we now see expensive homes and commercial properties. By enabling these essentially risk-free ownership propositions, the program opened the door for considerable development in exactly the places where flooding was most likely.

In addition to these significant problems, there are also very real questions as to whether program participants are staying current with their insurance payments. It appears that in many cases initial payments are made, but that, over time, payments cease. This brings into question the nature of the benefits provided to those who have stopped making payments. There are also a large number of property holders who live in the floodplain who are not required to obtain flood insurance because they do not have mortgages, their mortgages were not issued by federally insured entities, or that they live in areas behind manmade structures such as levees and dams.

While these property holders may be technically outside of the program, they still suffer considerable losses when flooding occurs. Compensation for these insured losses quite often comes directly from the taxpayer through ad hoc disaster assistance.

There is also a question as whether all the appropriate land areas are covered under the program. It appears that many of the homes destroyed by flooding in the Gulf region were located outside of the 100-year floodplain as determined by the Flood Insurance Rate Maps. The flood elevation levels on the current FIRM Maps were off by as much as 15 feet in certain areas of Mississippi and Louisiana.

In order for this program to regain its footing, I believe it is critical that the maps are updated to accurately reflect both flood elevation and flood depth. As it stands today, the Flood Insurance Program provides coverage for thousands of repetitive loss properties, vacation homes, and perhaps even a considerable number of structures that should never have been built. Its financial resources are insufficient to meet its financial responsibilities. It does not provide the taxpayer the benefit of prefunding losses that have become entirely routine. The fact is, the reality of the program and the expectations surrounding it are not in sync.

Many of these issues were central to the consideration of the Flood Insurance Reform Act of 2004, passed by this Committee last Congress. I, again, want to recognize the leadership roles of Senator Bunning and Senator Sarbanes in obtaining many needed reforms. But despite their efforts, I believe that it is now clear that significant reforms remain necessary.

This means that our Committee, and ultimately the entire Congress, must confront many tough policy questions. I certainly do not underestimate the difficult task that lies ahead. It is my intention to conduct a deliberative process so that whatever choices we may ultimately make, we shall make them with the full understanding of the true cost and the benefits associated with them.

I would also like to note at the outset of our consideration of the clearly troubled Flood Insurance Program, that I see very close parallels between this matter and others, where it has been suggested that the Federal Government should take on the role of insurer of last resort. Frankly, we should recognize that the bankrupt Flood Insurance Program provides us a case study for any such deliberations.

Furthermore, should we consider extending public liabilities in any such fashion, we will do it knowing full well the sum total of the additional responsibilities that we are placing on the taxpayers' shoulders.

Today, we have a very distinguished panel of witnesses, and I would like to welcome them all to the Committee. Our panel this morning including Dr. David Maurstad, Acting Director, Mitigation Division, Federal Emergency Management Agency; Mr. David Walker, who is no stranger to our Committee, the Comptroller General of the United States; Mr. Donald Marron, Acting Director, Congressional Budget Office.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

I would like to take just a moment at the outset to welcome Senator Menendez to the Committee. We are very pleased to have him join this Committee. Senator Corzine was a very valued Member of the Committee, and we know that Senator Menendez, with his experience in the House and his concern on a range of issues, will be an equally important Member. So, I extend to him a very warm welcome.

Chairman SHELBY. If I could join with you on that. I welcomed him a few minutes ago privately. We are expecting a lot of work out of you on this Committee.

[Laughter.]

And you will be up to the test.

Senator SARBANES. Mr. Chairman, I want to commend you for holding this hearing today. It is an important and critically timely issue with respect to the National Flood Insurance Program. Last October, actually, we began a review of this program, which insures almost 5 million properties across the country. Of course, recent developments have demonstrated major difficulties and weaknesses in the program.

To go back just a little bit, after Hurricane Isabel in September 2003, many of my constituents registered complaints about unfair treatment and inadequate settlements from FEMA under their flood insurance policies. We held hearings on that—Senator Bunning and his Subcommittee took the lead—and we passed some significant changes and reforms in the system including requiring FEMA to establish training guidelines for insurance agencies and an appeals process for policyholders with complaints.

I remain upset that not all of my constituents have yet had a resolution of their situation. We still have people living in trailers.

This hurricane was in September 2003. It is now January 2006, and I am sure some other colleagues of mine have similar difficult situations confronting their constituents. I have to say to FEMA that I think it reflects very poorly on the agency in that regard that these things have not been resolved.

I look forward to hearing from Mr. Maurstad this morning, the Acting Federal Insurance Administrator, as to how they are proceeding in implementing the reforms that were passed in this Committee and in addressing these claims.

Hurricane Isabel brought to light not only the administrative problems in the National Flood Insurance Program, Hurricane Isabel brought that to light. The recent devastation in the Gulf Coast has raised serious concerns about the fiscal posture of this program. Last November, we increased FEMA's borrowing authority to $18.5 billion. FEMA's most recent analysis shows that this funding, as I understand it, will pay flood claims through the middle of February, in other words, a few weeks to go. According to FEMA, there will be approximately $24 billion in legitimate, and I emphasize "legitimate" flood insurance claims, which, of course, means that the borrowing authority must be raised in order to allow the Federal Government to meet its contractual obligations to policyholders—let me repeat that—in order for the Federal Government to meet its contractual obligations to policyholders.

Obviously, we must ensure that policyholders are able to receive their settlements as soon as possible. Any delay in payments means a delay in rebuilding their homes and rebuilding their lives.

Clearly, we face major challenges in the Committee. Actually, the National Weather Service, Dr. Chris Landsea of the National Weather Service, who testified in October, said "Research suggests that many of the hurricane seasons in the next two to three decades may be more active than they were in the 1970's through the early 1990's."

Hurricane Katrina brought to our attention not only the great need for flood insurance, but also the extent to which people at risk do not have adequate flood coverage.

In some of the hardest hit areas of the Gulf Coast, flood insurance coverage was relatively high, even reaching over 50 percent in some areas. In other areas, however, only 5 to 10 percent of housing units had flood insurance. There are a number of reasons for low participation which needs to be addressed, I think, first and foremost by the administrators of the program, but, obviously, in an oversight capacity by the Congress itself. People do not understand or fully appreciate the risks. The flood maps are not accurate. Many are not required to purchase flood insurance.

We could not have avoided the hurricanes, but we can try to set up a system so there is adequate coverage for families, so people understand the risk, prepare to address those risks as best they can, and we have an obligation, I think, to ensure a financially sound flood insurance program, and one that prepares people for the natural disaster which may strike them.

Mr. Chairman, Committee staff members have visited the hardest hit areas of the Gulf. Five months after, the storm's debris still fills the majority of yards and streets. Mold is rapidly growing, increasing the damage to homes. Electricity has not been restored in many areas. People are sleeping in trailers, tents, even the second stories of their partially gutted homes. Clearly, people are not going to be able to get back on their feet without significant assistance. Some have flood insurance, many others have nothing.

We need to address this situation. It is a crisis within our own country, and I am increasingly becoming concerned that it is tending to slip from public view. It comes back into public view every so often, and then it fades away.

I hope these hearings will focus attention on this situation, that in the course of them we can map out long-run changes that will strengthen the program, enhance the coverage.

But I hope we do not lose sight of the short-run—well, for the people experience it is not short-run or long-run, it is all-run; that is what their life is all about right now—that we do not lose sight of the necessity of helping these people to get back on their feet and restoring some semblance of normality to their lives.

I will look forward to hearing from the witnesses, and I am very pleased that Comptroller Walker and Mr. Marron are here with us, and, of course, Mr. Maurstad, you are the point person on this thing, and I am sure that will become clear as we move into the question period.

Thank you very much, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman. I think you and Senator Sarbanes have covered the issue well, so I shall not try to expand on that.

I do want to extend a special welcome to Donald Marron, who used to be behind this, telling me what was going on to make me smart, and now he is in front of us.

Chairman SHELBY. He was telling us all.

Senator BENNETT. Telling me things I need to know to make me smart. I am very proud that I was the one that brought Donald up on the Hill as the Staff Director of the Joint Economic Committee, and I am glad to see how well he has prospered since he left us. So, welcome to him and to the other witnesses.

Senator SARBANES. We prospered while he was here too.

Chairman SHELBY. Our newest Senator, Senator Menendez, your first statement. You are recognized.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman. I want to thank you and Senator Sarbanes for the welcoming spirit that both you and the staff has extended to us, and I appreciate the opportunity to both learn and work with all the Members of the Committee in the days ahead on many of the critical issues that are within the jurisdiction of the Committee.

As it relates to today's important and timely hearing, I think that if anything has been learned from the events of 2005, it is that natural disasters, including flooding, can occur at any time and will continue to do so.

And for New Jersey, this is an incredibly important issue. Data shows that New Jersey has over 195,000 families who have flood insurance, which places New Jersey in the top five for the entire Nation. And the Flood Insurance Program has been very important for the people of New Jersey, providing over $575 million over 25 years to help people rebound after these floods, and so that is why I am pleased that we are taking a good hard look at the program, the debt the program faces, and the possible challenges that could be made to fix the program.

On the issues that we will be hearing about today, in addition to the issue of the borrowing authority and reaching the new borrowing limit as early as next month, that is something I look forward to hearing the testimony about. But another issue that is very important to New Jersey is the repetitive loss properties, and this is something that we are no stranger to. We have the third highest number of repetitive loss properties in the country, according to the Congressional Research Service. It is an issue I certainly want to look at carefully and thoughtfully, taking into account both the people who live in the houses that continuously get flooded, and those people who are subsidizing them through higher premiums.

It is estimated that New Jersey policyholders could save $10 million a year if we take steps to address repetitive loss properties, and I have no doubt that these policyholders would like to have access to that money, if at all possible, but creating the right balance between these competing interests is critically important to both New Jersey and the Nation, and I look forward to working with Members of the Committee as this process moves forward.

Thank you, Mr. Chairman, for the opportunity. I look forward to working with you and Senator Sarbanes and the rest of the Committee Members.

Chairman SHELBY. Thank you.

Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman. Thank you for holding the hearing. I think this series of hearings will lead to one of the most important legislative items we consider in this Committee this year. I think everyone in this room recognizes that there are serious problems with the National Flood Insurance Program.

As Senator Sarbanes said, in 2004, with the Chairman and Senator Sarbanes' help, and others, we set out to make important changes to the program, and we did so. Unfortunately, some of the most important reforms have still not been implemented 19 months after the law was signed, and over a year since the date set by the law. That is totally unacceptable. I hope and expect to get answers about when those reforms will be implemented today.

I hope this hearing will provide us with some ideas to make the Flood Insurance Program more solvent for the future. In 2005, we saw flood damage unlike ever before, but that does not mean it will not happen again. We must find a way to prepare the program to cover such massive losses and better protect the taxpayer. But we must also make sure that people in danger of floods inside the country, such as along the rivers in Kentucky, are able to have their claims taken care of while we are recovering from the hurricanes.

I know there are no easy solutions to the program's problems. We have some tough decisions to make, but they are necessary, and the price of doing nothing is too high.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Stabenow.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman. Happy New Year to everyone on the panel. It is wonderful to be back in session. I appreciate the leadership on the Committee. Thank you for holding this meeting on a very important topic.

I also want to welcome Senator Menendez. We served in the House together, where he was my senior Member, and it is now my great pleasure to be his senior Member, the one person I have seniority over on the Committee, and I want to maintain that position.

[Laughter.]

It is wonderful. I know you are going to add a tremendous amount of skill and knowledge to the process and the Committee.

As we have said, it has been exactly 5 months since Hurricane Katrina devastated the Gulf Coast. and with a number of Members of leadership, I visited shortly after the hurricanes, and there is no question the devastation is unimaginable. I know it is unimaginable to everyone who has gone, even now, and to see the lack of progress. The progress at this point has not been happening because of many reasons.

The National Flood Insurance Program, for 37 years, has been a critical part of helping these families and communities literally rebuild their lives, and it points up again the importance of that program to all of us in the States and communities we represent.

In Michigan, we hold more than 25,000 policies, and Michiganians have put $14.3 million toward the Flood Insurance Program, and it plays an important role for us in Michigan, as it does for other States. Unfortunately, the devastating 2005 year of storms led the program far beyond capacity, and that is, of course, why we are here today, faced with the challenge of exploring new options to cover the shortfall.

It is clear to me, as it is to all of us, that something must be done. We must ensure that communities work with property owners to improve flood preparations. We must properly educate policyholders so that no family is surprised when something is not covered, and guarantee that families will receive the coverage that they have in a timely manner. We must also find new ways of mitigating future losses in disaster-prone areas. Last, we must find a way to protect the program and strengthen it. It helps families and communities when they need it most.

I also hope that in this exploration of solutions, we are aware of the potential impact various ideas could have on the Nation and on our States, and I would just point up one area of concern that my State has voiced. There are a number of homes, in fact, 63,000 Michiganians that could face higher cost to owning their current home, depending on what is done, and I worry that policies expanding the geographical areas and increasing the rules for mandatory flood insurance could hurt Michigan families, especially those who are already faced with mortgage payments and increasing interest rates, and this is an area that I will be watching closely. So, I urge that, as we consider this very important topic.

Mr. Chairman, thank you very much for bringing this up early in the session. I hope that we will be able, as we have done in so many issues, to come together in a balanced way for the people that we represent.

Thank you.

Chairman SHELBY. Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. I do not have an opening statement at this time. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thank you, Mr. Chairman.

To our witnesses, welcome. Thank you for joining us today.

In 1989, as Hurricane Hugo was bearing down on the East Coast, I was part of an effort over in the House of Representatives to reform the National Flood Insurance Program. Senator Bunning and I served at one time together, I believe on the House Banking Committee, and it was an issue of some concern to us at the time, an issue that he has continued to address here in the U.S. Senate.

At the time we were concerned about low participation rate. And I am not sure, Mr. Chairman, if you were in the Senate then or in the House.

Chairman SHELBY. In the Senate.

Senator CARPER. You were in the Senate, a refugee from the House.

Chairman SHELBY. I was a refugee.

Senator CARPER. At the time we were concerned about the low participation rates in the Flood Insurance Program. I drafted a proposal to increase participation by requiring mortgage lenders to escrow flood insurance payments, just like many do for homeowners insurance. We were also concerned about the fact that a small percentage of properties have been responsible for more than a third of all claims, costing about $200 million annually.

My proposal included a call for flood-proofing or—I think Doug Bereuter from Nebraska was my cosponsor, as I recall. But our proposal included a call for flood-proofing or removing those properties, and reserved a small amount of funds collected from flood insurance premiums to pay for this. We also sought to limit new construction in coastal areas that were quickly eroding. And our proposal sought higher, more appropriate premiums for those who lived in those vulnerable locations.

In 1989, 16 years ago, a bill to reform the Flood Insurance Program was passed, one not as far reaching as our proposal, but a step in the right direction. It was passed by both the House and Senate before running into trouble in conference, where, unfortunately, it died.

Today, in the wake of Hurricane Katrina, a couple of particularly destructive hurricane seasons, we find ourselves again looking at the National Flood Insurance Program, barely a year after taking up legislation authored by Senator Bunning. Our main concerns now, low subscription rate, the repetitive loss properties, the low premiums that do not reflect the vulnerability of the property being insured.

This time the tragedy of Katrina will stay with us for a long time because the rebuilding will take many years, causing us in Congress and the Administration to continue writing checks for many years. While this is not something any of us want, perhaps it will keep the pressure on us long enough to pass a bill that truly improves the Flood Insurance Program this time, one that will require us to better consider where we build and rebuild, how we build, and how we allocate risk.

I look forward to working with all of our colleagues, and certainly with Senator Bunning, who has had a longstanding interest in this issue.

In closing, I just want to join Senator Stabenow and others in welcoming Congressman Menendez. I left the House at the end of 1992, and I think you were coming maybe about the time that I left, but I am delighted that you are here and look forward to working with you on this Committee and in the Senate. Welcome.

Chairman SHELBY. Senator Dole.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Mr. Chairman. Thank you for holding this hearing this morning on the proposed reforms to National Flood Insurance, a program which covers approximately 147,00 homes in North Carolina, many of which have felt the impact of flooding in the wake of hurricanes like Isabel, Frances, Ivan, and most recently last summer Ophelia.

We in North Carolina recognize our vulnerability to flooding, and we are taking productive and proactive steps by undertaking one of the most advanced mapping programs in the Nation to better identify areas of risk. With FEMA's essential support, our maps provide community, State, and national leaders with clear delineations regarding the areas vulnerable to floods. This allows our communities to properly plan for current and future development.

The availability of flood insurance also provides needed security for these communities. No one could have foreseen the strains that Hurricanes Katrina and Rita would place on this critical program. In December, Congress raised the program's borrowing authority, as the Chairman has said, to $18.5 billion. Still, FEMA anticipates as much as $23.5 billion in claims, more than the program has paid out in total over its more than 30-year history.

FEMA informs us that its current borrowing authority will only provide enough funds to last through mid-February, again, as the Chairman has indicated. Clearly, Congress will soon need to raise further the borrowing authority for the program, and we again should not hesitate to do so.

In addition, I strongly support efforts to make responsible reforms to strengthen and improve the program. However, we must fully understand the impact of any change before its implementation.

Three reform proposals are of particular concern to me, Mr. Chairman, because of their possible negative impacts on North Carolina: First, moving from the current 100-year floodplain insurance requirement to a 500-year requirement. Since North Carolina has advanced floodplain maps, it is clear where our 500-year floodplains are located. However, flood maps in other States have, for the most part, only gotten older. In fact, according to FEMA, only 25 percent of 500-year floodplains have been mapped. We would need to know how and if other States with less sophisticated maps would be able to implement this policy.

I also find it troubling that, according to the North Carolina Floodplain Managers Association, this policy change would require 15 to 20 percent more North Carolinians to purchase flood insurance. This would largely impact people in the poorer areas of eastern North Carolina. Such a change in policy should not disproportionately affect North Carolina, particularly those in poorer areas.

If Congress were to approve a 500-year floodplain purchase requirement, I would certainly hope that families subject to this new law would pay premiums that reflect the lower risk of their area. We must have assurance of this before even considering any such proposal.

Second, in 2004, this Committee approved and the President signed into law legislation reauthorizing the Flood Insurance Program. In the 2004 Act, we defined a repetitive loss as four events or more that have claims of more than $5,000. Given North Carolina's history of hurricanes, I believe that a proposal to remove families with four or more claims will make most of eastern North Carolina ineligible for the program. I would hope that the Committee would consider such a reform's impact on their State as well.

Finally, I am concerned about a proposal to more than double the current 10-percent per year cap on flood insurance premium increases. While I understand the great need to bring additional funds into the program, a consistent 25-percent increase in flood insurance premiums for the next few years is excessive and, therefore, this also needs to be reconsidered.

It is my hope, Mr. Chairman, that with a clearer understanding of the consequences of these reforms, we can quickly come to an agreement and move forward with a suitable proposal that will ensure that this important program continues. Families in North Carolina and throughout our Nation certainly deserve the security and peace of mind that the National Flood Insurance Program provides.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Martinez.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Thank you, Mr. Chairman, and thank you for holding this important hearing today. It is for me a great pleasure to also welcome Senator Menendez to the Committee and to the Senate. I am extremely proud of his ascension. And I also know many of my fellow Floridians share in the pride of your new status as one of our Senators, and we very much welcome you here. I look forward to working with you.

Mr. Chairman, my State, like other coastal States, as Senator Dole just alluded to, is susceptible to flooding and is painfully aware of the devastation hurricanes can cause. The past two hurricane seasons have been horrendous for Florida.

As I traveled throughout my State after Hurricanes Ivan, Charley, Jeanne, Frances, and Katrina, we saw the horrifying power and fury of natural disasters. I met with families burdened by extensive damage to their homes, worrying about how they would make their next mortgage payment, concerned about increasing insurance deductibles, multiple insurance deductibles, and facing the decision of rebuilding or relocating. And with the consideration of relocation came the concerns of finding new work and new housing that is affordable.

I also became aware how incredibly important National Flood Insurance Program was to Florida families trying to rebuild their lives after hurricanes and flooding damaged their homes and communities.

As the 2005 hurricane season came to a close, there were nearly 2 million NFIP policies on homes in Florida, 41 percent of the entire program, representing 42 percent of the program's total assets. After four hurricanes devastated my State over the 6-week period in 2004, FEMA called upon Congress to increase the National Flood Insurance Program's borrowing authority and allowed it to borrow $300 million to pay roughly $1.8 billion in claims.

Since Hurricane Katrina's unprecedented impact on the Gulf Coast, Congress has authorized increased borrowing authority for the NFIP several times, totaling more than $18 billion. It is the NFIP's legal responsibility to pay claims of flood insurance policyholders, and that is why we must quickly approve the additional borrowing authority needed to pay outstanding claims from last season's terrific hurricane losses.

The strengthened viability of the National Flood Insurance Program is more important to my State than to any other. Serious reforms need to be made to the program to ensure that those who rely on flood insurance continue to live and work in their communities and that they will have the security that they so desperately need and must rely upon.

I am looking forward to today's panel. I want to thank our witnesses for being here. I have reviewed several of the reform proposals that are being discussed within the Committee, and I am very concerned about the impact that they would have on my constituents.

As was just pointed out by Senator Dole, I share many of her concerns. Many hard-working families are greatly in need of this program in Florida. As I visited the community of St. Marks, a poor fishing, working-family place in north Florida, I was taken with the fact that the impact of this program is not just on the affluent but is really on poor working families.

Mr. Chairman, I appreciate your attention to this issue, and I am ready to work with you to develop a reform plan that takes into consideration all possible implications of the proposals that we will hear about today.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman, and, again, I want to thank you for holding this hearing on proposals to reform the National Flood Insurance Program.

Flood insurance is an important program for my constituents in Colorado as well as for citizens of coastal areas. While our risks may be different—dams instead of oceans or spring snow melt runoff instead of hurricanes—they are just as real. Geography can also present a significant danger in Colorado. As rain is funneled into mountain valleys, it can produce catastrophic results such as happened in the Big Thompson flash flood in my hometown area where many people lost their lives.

In such instances, the Flood Insurance Program can be an important Government tool to help prevent or minimize flood damage and facilitate recovery efforts when damage does occur. Under the leadership of Senator Shelby, Senator Sarbanes, and Senator Bunning in 2004, the Committee produced a series of important reforms designed to make the National Flood Insurance Program more effective, and I was pleased to support the legislation. While that legislation was a great step, the National Flood Insurance Program is now faced with new challenges that will require further legislation.

As the National Flood Insurance Program begins processing the thousands of claims resulting from the 2005 hurricane season, it will face stresses unlike any previous year. In fact, estimates indicate that the flood insurance claim payouts for 2005 could be more than the total of all payouts over the entire life of the program. Without significant reform, the program faces insolvency.

We must prevent that from happening. Not only do we have a legal obligation to pay the claims of those who purchase flood insurance policies, but we also have an ethical obligation to the people who are responsible enough to buy appropriate insurance. We must ensure flood insurance continues to be available for those who need it as well as doing everything we can to protect taxpayer dollars. On this point, I remain deeply concerned over the effect of the ongoing subsidies for certain properties. We must move more strongly toward an actuarially sound flood insurance program.

I am also concerned about the state of the floodplain mapping. An effective Flood Insurance Program is predicated upon accurate, current floodplain maps. Local community mitigation and prevention efforts are only as good as the maps on which they rely. I am interested in finding ways to utilize technologies such as satellites and aerial mapping capabilities to improve and speed up the current mapping system. In Colorado—and I do not believe we are unique in this regard—many of our floodplain maps are outdated by a large number of years, in fact, decades. I think those maps need to be updated, and I do not think our situation is unique. I think that perhaps North Carolina might be unique in the fact that they have taken the initiative on updating their maps.

Millions of people have taken steps to protect their homes and families by purchasing a flood insurance policy. We must be careful that as part of our reform efforts or more general disaster assistance not to create a moral hazard. In fact, we need to find ways to improve the flood insurance participation rates.

I look forward to working with my colleagues to find the necessary reforms to ensure the long-term solvency of the National Flood Insurance Program, and thank you to the witnesses for being here today to share your perspectives with us.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Senator Allard.

Mr. Walker, we will start with you. All of your written testimony—a lot of us have reviewed it—will be made part of the hearing record in its entirety. You may proceed as you wish, Mr. Walker. Welcome back to the Committee.

STATEMENT OF DAVID M. WALKER

COMPTROLLER GENERAL OF THE UNITED STATES

Mr. WALKER. Thank you, Mr. Chairman. It is a pleasure to be back before the Senate Banking Committee.

I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program. I, like many of the Members of the Committee, have had the opportunity to visit New Orleans and the Gulf Coast in light of the devastation caused by Hurricanes Katrina and Rita, which is one of the reasons that we are here today, but not the only reason. Clearly, Hurricanes Katrina and Rita represent a tragedy for hundreds of thousands of our fellow Americans. Their lives have been turned upside down, and many who would have benefited did not have flood insurance.

At the same time, I think we need to recognize that out of this human tragedy comes an opportunity and, in fact, a need for the Congress to fundamentally rethink the Flood Insurance Program. How can it best be structured to provide financial protection from flooding for those who need it and would benefit from it, while at the same point in time, helping to assure that this program is solvent and sustainable over the longer-term.

I hate to say it, Mr. Chairman, but this is a subset of a much broader challenge that we face because this is not the only Federal insurance program in trouble, but we will focus on this one today.

The program was established in 1968 to provide policyholders with some insurance coverage for flood damage, as an alternative to disaster assistance, and to try to reduce the escalating costs of repairing flood damage.

Flood maps identify the boundaries of the areas at greatest risk of flooding; however, as Senator Dole mentioned and Senator Allard just followed up on, some maps for various States are more up-to-date and more comprehensive than others are.

From its inception in 1968 until August 2005, the program paid out about $14.6 billion in insurance claims. However, FEMA now estimates that Hurricanes Katrina, Rita, and Wilma are likely to generate claims and associated payments of about $23 billion—far exceeding total payments over the previous roughly 30-year life of the program.

Given prior experience, the design of the program, as well as recent claims, the National Flood Insurance Program is not only not actuarially sound, but also it will not be able to absorb the total costs associated with these new claims. On November 21 of last year, FEMA's authority to borrow from the Treasury was increased from $1.5 billion to $18.5 billion through fiscal year 2008. But as you mentioned, Mr. Chairman, that is expected to run out mid-February. By the way, the overall debt limit is expected to run out in mid-February as well. I just came from a meeting with the Secretary of the Treasury.

Chairman SHELBY. How much more money are they going to need, in your judgment?

Mr. WALKER. I am looking forward to hearing from the FEMA Director on that. Several billion is my understanding. But I look forward to hearing from him on that, Mr. Chairman.

A key characteristic of the Federal Flood Insurance Program is the extent to which FEMA must rely on others to achieve the program's goals, and in this regard, based upon GAO's past work, we have identified several major challenges facing this program: First, the need to reduce losses to the program resulting from policy subsidies and repetitive loss properties; second, the need to increase property owner participation in the program; third, the need to develop up-to-date and accurate digital flood maps, especially in light of recent tragic events; and last but not least, the need to provide efficient service and effective oversight of flood insurance operations.

As of January 2006, FEMA had not yet fully implemented the provisions of the Flood Insurance Reform Act of 2004, which has been mentioned and referred to by several of the Senators. The 6-month statutory deadline for implementing these changes was December 30, 2004. I think it is important to note that in September 2005, FEMA did post a Flood Insurance Claims Handbook on its website.

With respect to the appeals process, FEMA has not yet stated how long it thinks its rulemaking is going to take to make this requirement a reality. And with respect to the training and education requirements for insurance agents, FEMA published a proposed notice on September 1, 2005, which included some online training materials. We have recommended that FEMA develop documented plans with key milestones for meeting this requirement. To my knowledge, they have yet to do that.

In summary, the most immediate challenge for the Federal Flood Insurance Program is processing the flood insurance claims resulting from Hurricanes Katrina and Rita as well as, obviously, outstanding issues from prior tragedies.

Progress is being made with regard to Katrina and Rita. In December 2005, FEMA estimated that it had paid about 70 percent of Hurricane Katrina claims totaling about $11 billion, some of them using expedited procedures to assist policyholders who were displaced from their homes. In the longer-term, Congress and the Insurance Program face a complex challenge in assessing potential changes to the program that would improve its financial stability, increase participation in the program by property owners in areas of risk of flooding, reduce the number of repetitive loss properties, and maintain current and accurate floodplain maps. These issues are complex, interrelated, and are likely to involve trade-offs and a balancing of interests.

There is no silver bullet, but it is clear that in addition to additional borrowing authority, this program is in need of fundamental reform if we expect it to exist over the long-term. I wish it was the only one in this shape, but let's deal with one of them at a time.

Thank you, Mr. Chairman. I am happy to answer your questions.

Chairman SHELBY. Thank you, Comptroller General Walker.

Mr. Maurstad.

STATEMENT OF DAVID I. MAURSTAD
ACTING DIRECTOR, MITIGATION DIVISION
AND FEDERAL INSURANCE ADMINISTRATOR
FEDERAL EMERGENCY MANAGEMENT AGENCY
U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. MAURSTAD. Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I am David Maurstad, Acting Mitigation Division Director and Federal Insurance Administrator for FEMA within the Department of Homeland Security. I appreciate the opportunity to be here today to discuss the status of the National Flood Insurance Program, particularly after the devastating effects of last year's hurricane season.

This morning, I would like to address three areas: First, FEMA's implementation of the 2004 Flood Insurance Reform Act; second, NFIP's financial status; and, third, strengthening the NFIP with meaningful structural reforms.

Since the June 30, 2004 signing of the Flood Insurance Reform Act, the Nation has endured consecutive hurricane seasons of catastrophic proportions. Through the Reform Act, we initiated improvements in 2004 that enhanced our ability to serve policyholders in 2005. We now have the opportunity to press forward with further reforms and fundamentally change and strengthen the financial underpinnings of the program.

The 2004 hurricane season resulted in over 75,000 claims totaling close to $2 billion. Our ability to quickly resolve these claims was due in large part to our ongoing public awareness activities as well as our work with the insurance industry to learn how the Reform Act could best be used to improve policyholder understanding of NFIP coverage.

The 2004 hurricane season experience, combined with our effective FEMA-insurance industry partnership, resulted in two Reform Act-required documents: The NFIP Summary of Coverage and the Flood Insurance Claims Handbook.

Immediately following Hurricane Katrina, we distributed these documents to policyholders to help them through the claims process. These materials have been made available in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers, as well as in town meetings, since September 1, 2005, and their effectiveness at clarifying the claims process for our Gulf Coast policyholders has played a big role in FEMA's ability to resolve over 70 percent of the 239,000 claims policyholders have filed, more than triple the number of claims filed in all of 2004, and totaling over $3.5 billion in claims payments so far.

The large number of claims and the severity of flood losses from the 2004 and 2005 hurricane seasons are unprecedented, yet the NFIP continues to effectively meet the needs of policyholders and communities as designed. We are obligated to ensure that our policyholders with covered claims are paid as quickly as possible, and it is imperative that the NFIP claims process continue uninterrupted.

In October, I informed you that we expected the total NFIP payout for these events to be over $23 billion, $8 billion more than all of the claims paid in the entire history of the NFIP. The results of our ongoing assessments indicate that these estimates remain on target. As you will note in Exhibit 1, claim payments will exceed $22 billion for Hurricane Katrina alone.

In November, Congress increased NFIP's borrowing authority to $18.5 billion, allowing the NFIP and the write-your-own companies to continue to effectively serve our policyholders. As indicated in Exhibit 2, we will approach that limit on or around February 10, 2006.

The historic hurricane seasons of 2004 and 2005 have called our attention to the challenges facing the NFIP, as you have all indicated. Now is the time to complement our mitigation and insurance principles with meaningful structural reforms. To fundamentally change and strengthen the NFIP, we believe Congress should consider the adjustments recommended in my written testimony. Rather than speak to each one of these recommendations, I would like to use my time to highlight a handful of them.

First, provide authority to eliminate over time subsidies for properties built before flood insurance rate maps were in place. When fully implemented and assuming no loss of policyholders, subsidy elimination would provide the NFIP $850 million more a year to pay future flood insurance claims.

Next, strengthen the mandatory purchase requirements by increasing penalties for noncompliance and requiring more frequent and thorough lender portfolio review.

In addition, we ask that you direct FEMA to study the feasibility and implications of expanding the standard for mandatory purchase requirements to include the 0.2-percent chance per year floodplain—or the 500-year floodplain—and properties in areas of residual risk, those areas protected by levees, dams, and other manmade structures.

Also, provide additional Increased Cost of Compliance coverage, and remove the $75 cap on ICC premiums so that a variety of ICC options can be offered to policyholders.

And, last, provide FEMA and the NFIP with the resources and time needed to effectively implement programs and adjustments.

NFIP changes, 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 easy solution or single remedy that will enable the program to absorb catastrophic loss years as we have just experienced. Bold and meaningful reforms must be pursued that create safer communities, enable individuals to recover more rapidly from flood disasters, and lessen the financial impact of flooding on the Nation.

To conclude, we expect to reach our borrowing limits by early to mid-February. In order to continue to meet existing claim obligations, the NFIP will need an additional $5.6 billion in borrowing authority to cover claims and expenses through fiscal year 2006. Additionally, the limitation on interest payments to the Treasury needs to be waived or raised to at least $670 million for the program to meet its obligations to the Treasury.

I look forward to continuing to work with the Committee, the NFIP write-your-own companies, agent groups, and other partners to fully implement the 2004 Flood Insurance Reform Act, to implement meaningful structural reforms to NFIP, and to continue helping Gulf Coast communities rebuild stronger and smarter so that they are less vulnerable to future flooding events.

Chairman SHELBY. Thank you.

Mr. Marron, welcome back to the Committee.

STATEMENT OF DONALD B. MARRON
ACTING DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. MARRON. Thank you, Chairman Shelby, Ranking Member Sarbanes, Members of the Committee. It is a pleasure to be here today to talk about flood insurance, and it is a pleasure to be here today on this side of the dais after having the experience of being on the other side. I have great respect for the staff of this Committee.

The recent Gulf Coast destruction highlights obviously the value that flood insurance brings to the homeowners and property owners who have it. It is very important in reducing the risks they face. But it also brings home in a dramatic way the potential costs to American taxpayers.

In preparing for this hearing, the Committee asked CBO to look at three specific issues: The first was to quantify the level of subsidies that exist in the program as it is today; the second was to look a little bit at what might happen if efforts were taken to reduce those subsidies, what the effects might be on the program and on our participation in the program; and then, third, to think a little bit about the current budgetary treatment of National Flood Insurance and about what alternative treatments might be. And so I will go through each of those really quickly.

First, as many people have noted in their opening statements, the program as currently designed is designed to lose money. About a quarter of the properties in the program are explicitly subsidized. By our calculations, using some data we got from FEMA, the average subsidized property pays premiums now of about $700 per year, and if we charge them actuarially fair rates, that number would be closer to $1,800. The first thing to note about those numbers is that both of those numbers are actually pretty large relative to the incomes and means of many Americans, and those numbers are a signal of the great risk that many of these properties pose.

So if you take those numbers, they imply about a $1,000 subsidy, a little bit more, per property in the program. There are 1.2 million subsidized properties in the program. Multiplying that out you get a subsidy per year that is in the neighborhood of $1.3 billion—a significant chunk of change, serious money. One way to put that in orders of magnitude is to note that the program as a whole receives premiums of about $2 billion, so it's about half again as much.

Congress obviously has the opportunity now to consider whether steps should be taken to reduce the subsidies that are offered to these programs. Obviously eliminating them entirely would have the implication of raising premiums for these properties by about 150 percent on average, some more, some less. And if you think through qualitatively what the effects of that would be, it is pretty straightforward.

There is some group of property owners who value the insurance greatly and who would be willing to pay those higher premiums and would provide greater resources to the fund. There are some policyholders who value insurance to a certain extent, but given the financial hit of paying the higher prices would ratchet back their coverage. And so instead of maybe having $200,000 of coverage, they might ratchet it back to $100,000 of coverage in order to reduce their overall expenses on the insurance. And there are obviously some policyholders who, when they saw the premium increase, would be motivated to try to drop the coverage.

If you ask us to try to quantitatively estimate how all those different reactions net out and what would be the effect of eliminating the subsidies, it is hard to tell. There are not that many studies that have looked rigorously at the behavior of people and how they respond when you change their insurance rates. The studies that exist are relatively dated. They look at behavior from the 1980's and 1990's, a different period and also different kinds of price changes. This is talking about a very large change in the premiums that would be charged.

But if you take those studies at face value, they would suggest that a significant number of people would ratchet back their coverage, some fraction would drop their coverage, and that the net effect on total dollars coming into the program may not be that large.

Now, when you think about it purely from the program's point of view, the effects are more straightforward. As you move toward actuarial fairness, two things happen. Some participants in the program pay you more money. Some of them ratchet back their coverage. And on net, from the program's point of view, if you get to actuarial fairness, it will be on an actuarially sound basis. You know, you can get there either by raising more money or by driving risk out of the system. And a key policy concern would be that as you move in that direction, there is a concern about participation in the program, and obviously one side effect of raising premiums would be that fewer people had full coverage.

A second effect to keep in mind is that, as people become less insured or have no insurance, there is a question about what kinds of payments they might receive after a disaster when people see that they weren't insured and through a political process or through charity or through other kinds of processes want to provide assistance to them. And so if you think about it from the overall Federal budget point of view, you would have to take those effects into account as well.

Finally, turning quickly to the budgeting for the program, the National Flood Insurance Program, like many insurance programs, is currently budgeted on a cash basis. We had the phrase earlier, "writing checks," and that is basically the way it shows up in the budget. It is a very convenient way to track the inflows and outflows to the program, but it does not specifically bring to the forefront the subsidy that is built into the program.

Taking a step back, if you think about what the program is, we are really doing two things as a Nation through the Flood Insurance Program. One is we are providing these subsidies to certain property owners, and the other is that we are acting as an insurance company. It is difficult to design a budgetary treatment or a single budgetary measure that is going to reflect both of those activities, acting as an insurance company and providing subsidies. The current system is designed to focus on the cashflows.

And so, for example, when you see CBO's projections of what the cost of the program will be in future years, you will basically see payments that are going out for Katrina-related losses, and because of the borrowing limit you will essentially see those stop at some point, because the borrowing limit, under CBO's rules as we project out the budget impact of the program, you basically just see that spending happens up to the borrowing limit and then stops. That is a treatment that is very good at highlighting the cash implications of the program, but doesn't necessarily highlight the subsidy aspect of it.

A plausible alternative budgetary treatment would be to explicitly account for the subsidy and focus on that in the budgetary treatment. Under the Credit Reform Act, we do something similar to that for the treatment of student loans and guaranteed loans of various kinds where, when those activities take place, we reflect in the budget immediately an estimate of what the subsidy value is. That approach emphasizes what the subsidy is at the time that it is incurred, when the financial contract is entered into, but you should keep in mind that that involves judgment and estimates. It is hard to know in advance what the actual estimate will be, what the actual subsidy will be. You know, there is no particular reason from our point of view to doubt FEMA's estimates of what the actuarial rates should be and what the subsidy is. But, you know, it is only over time that we are going to learn what the true extent of the subsidies in the program are.

And so a subsidy approach would be a plausible way of having budgeting that focuses on the subsidies that are built in, but it would not have the convenience of the cash focus that shows you really the cash inflows and outflows that the Government receives.

And with that, I look forward to your questions.

Chairman SHELBY. The National Flood Insurance Program, it is my understanding, was originally created to reduce losses to the Federal Government, the taxpayer, and individual households from flood-related damages. It seems that flood costs have only continued to rise. This program obviously is broken. It has never been actuarially sound, to my knowledge. Mr. Marron and Mr. Walker, I will direct this question to you. To what extent do you believe the availability of flood insurance, particularly at subsidized rates, has only encouraged people to place themselves in harm's way and continue to rebuild in flood-prone areas?

Mr. Walker.

Mr. WALKER. I think there is no question that, to the extent that you are providing insurance at subsidized rates, combined with the fact that if you were building in an area that is grandfathered from the building requirements, can create perverse incentives for people to build or rebuild in areas of high risk.

Chairman SHELBY. And they assume very little of the risk. Is that right?

Mr. WALKER. They do not assume appropriate risk. That is correct. I think one of the things that the Congress will need to do in relooking at this program is try to understand what are you trying to accomplish. There are differences between properties and individuals. Some properties are in flood-prone areas that are heavily populated and need to be heavily populated for various reasons. They may be populated by people of more modest means. Other flood-prone properties may be predominantly secondary homes or vacation homes, populated by individuals who are of significant means.

And so there are various issues that should be looked in determining the best way forward, not only as to what should be insured, but at what levels and at what premium rate.

Mr. MARRON. Just to build on that, one of the key roles of insurance premium is to provide an incentive for property owners to take actions that would reduce that premium.

Chairman SHELBY. Assume some of the risk, in other words.

Mr. MARRON. Right, to assume the risk or to do things to make that risk go away. Obviously, what you can do depends a lot of your specific property, but clearly, various property owners have the ability to elevate, to move their property, to engage in other behavior that would reduce the potential exposure and the potential risk. And if you offer them subsidized insurance rates, some of that incentive goes away.

Chairman SHELBY. Mr. Walker, would you like to comment on the program's ability, the current program's ability to repay the borrowing that you referenced earlier from current premiums? I do not know how they could very repay the borrowing from——

Mr. WALKER. They are not going to be able to repay the $18.5 billion under the current structure. You are going to need to reform the program. Unfortunately, this scenario is very similar to another scenario, and that is the Pension Benefit Guaranty Corporation. They both have about $23 billion accumulated deficits. They have both gotten that way within the last 3 or 4 years. I think one of the things that you are going to have to do is not only reform the program, but also have a discussion about sunk or legacy costs versus going forward costs. I think you are going to have to have a discussion and debate about that for the NFIP as well as the PBGC.

Chairman SHELBY. Whatever we do, we better look at the actuarial soundness of the program, had we not?

Mr. WALKER. You should, yes. It should be designed to be solvent and sustainable over the long-term.

Chairman SHELBY. The National Hurricane Center, as you well know, is predicting in the next couple of decades that it will bring extremely active hurricanes. We hope not, but it probably will.

What implication does the hurricane forecast have for the fiscal health of the Flood Insurance Program?

Mr. Marron.

Mr. MARRON. I am obviously not a meteorologist, and we do not have many meteorologists on staff at CBO. But, if true, that would suggest that over time the actuarially fair rates would go up. And to the extent there was any impediments to charging those rates, the subsidies would build in the program.

Chairman SHELBY. So we better build in any program to consider that, had we not?

Mr. MARRON. Absolutely. The best insurance premiums are those that reflect the actual risks that people expect there to be in the future.

Chairman SHELBY. Do you agree with that, Mr. Maurstad?

Mr. MAURSTAD. Yes, I do. I think that it is important we look at moving toward all of the policies in the program being risk-based in premium. I think it also illustrates that we need to continue to work very aggressively with the pre- and post-disaster mitigation programs along with the flood mitigation assistance dollars, and hopefully by the end of this fiscal year, the Severe Repetitive Loss Pilot Program to mitigate and help policyholders mitigate against future losses.

Chairman SHELBY. Why do you believe that families choose not to buy flood insurance? Is it because they are not aware of the program or they do not want to assume the risk or what?

Mr. MAURSTAD. I believe past studies and inquiries have indicated there are generally three reasons: One, a cultural difference in insuring for flood, which people believe will not happen to them, as opposed to fire, which is actually less likely to happen to them; the cost of the program; and in many cases, people indicating they were unaware. And so that is why we continue with our Flood Smart public awareness campaign, working with communities, working with agents, working with ASFPM and other partners on making sure that the individuals understand what their risk is so that shared responsibility can have better results.

Chairman SHELBY. Mr. Walker, do you have any comment?

Mr. WALKER. There are several reasons. Part of it might be awareness. Part of it might be the fact that, human nature being what it is, many people believe that it is not going to happen to them. By definition, when you say 100-year floodplain, a one percent chance each year, and with the amount of time that many people stay in a particular residence, they discount the likelihood it is going to happen to them. Some may have issues with regard to affordability.

Think of young people. Why do young people not buy health insurance? They do not think they are going to get sick.

Chairman SHELBY. And a lot of them do not get sick.

Mr. WALKER. But some of them do.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Mr. Maurstad, I want to address the housing situation of the Katrina evacuees first. I have been quite concerned about this. I am very disappointed with FEMA's insistence on making decisions about continued eligibility for housing assistance on a case-by-case basis instead of putting out clear and transparent guidance.

Now, the Congress in the conference report on the defense appropriations bill put the following directive: "The conferees are concerned with the lack of guidance on housing assistance. Within 2 weeks from the date of enactment of this Act, the Director of FEMA shall issue guidance used to determine continued eligibility for housing assistance under the Section 408 program. Consistent with current FEMA regulations, such guidance shall include the extension of assistance if the recipient is unable to afford local housing at the fair market rent level."

Now, that 2-week deadline ended on January 13. Has this critical guidance been issued?

Mr. MAURSTAD. Senator, the housing area is outside my scope of responsibility in the NFIP and the mitigation program. I know our recovery people are actively working on that. I will carry your concern back to Acting Director Paulison, and we will get you a response for that. But I do not have that answer.

Senator SARBANES. When you say they are actively working on it, I take it that means that it has not been issued as yet.

Mr. MAURSTAD. I do not know, sir.

Senator SARBANES. You do not know. Well, if you could get an answer, we would appreciate that.

Mr. MAURSTAD. I will.

Senator SARBANES. We also understand that FEMA has indicated they will stop reimbursing localities for debris removal at the beginning of March. Now, Katrina was an unprecedented disaster that left an extraordinary amount of debris. Cleanup in some neighborhoods has not even begun. Can FEMA extend this deadline?

Mr. MAURSTAD. Sir, I was down in the Gulfport area the week before last and evidenced what you have indicated there. Again, I apologize. It is a similar answer that I gave you before. It is under our Recovery Division, Recovery Director. I know from sitting in meetings that they are looking at all these issues. Specifically as to whether or not that deadline can be extended, I will, again, get you an answer from Acting Director Paulison or the Recovery Division Director for you.

Senator SARBANES. Were you struck by your visit down there of the need to extend the deadline with respect to debris removal just as an informed observer?

Mr. MAURSTAD. Sure. The handful of visits that I have had down to the Gulfport area, the devastation, as you know, is widespread. It is over a larger area than we have ever experienced before. It is a monumental task and chore. So certainly the removal of debris continues to be one of the high priorities of the Department.

Mr. WALKER. Senator Sarbanes, may I add?

Senator SARBANES. Yes, certainly.

Mr. WALKER. I had the opportunity to tour New Orleans and southern Mississippi as well as southern Louisiana. Clearly, there is a tremendous amount of debris removal that still has to be done.

It is my understanding, Senator, although I will double-check this and provide it for the record, that the President has the authority to extend the timeframe to do debris removal and for the

Federal Government to pick up the entire cost. I believe that is within his discretion. It is something I believe he has done at least once before and may need to considered again, given the status of recovery.

I would also respectfully suggest that one of the problems that exists in the area is that the States and localities need to develop a plan regarding where debris removal should take place, where leveling should take place in order to prepare the way for reconstruction. The Federal Government may want to think about extending full Federal payment for debris removal if there is a plan that addresses what the States and localities plan to do on a going-forward basis with regard to reconstruction. There needs to be some linkage here because it is a shared responsibility between Federal, State, and local government. In some cases, there are problems in connection with various governmental levels in doing what they need to do in order to take care of the people in need.

Senator SARBANES. I understand in Pass Christian, Mississippi, the Army Corps of Engineers is contracted to remove the debris, yet very little of it has yet been removed.

Mr. WALKER. It is also my understanding that there is a bid protest that has been filed with the GAO with regard to one of these requests for proposal, We are moving expeditiously to try to deal with that. At the same time, it is also my understanding that the Army Corps of Engineers can, if there is a clear and compelling national interest to move forward.

They did use that in the case of Iraq and theoretically they have the ability to it in the case of an unprecedented national disaster such as this—or natural disaster in the Gulf Coast such as this.

Senator SARBANES. Mr. Maurstad, when you appeared in October, we made it clear that we expected the 2004 Reform Act to be implemented, including the requirement to implement a formal appeals process which was supposed to have been implemented by the end of 2004. Has a formal appeals process now been put into place?

Mr. MAURSTAD. Senator Sarbanes, we are absolutely committed to implementing all aspects of——

Senator SARBANES. Well, I heard that before.

Mr. MAURSTAD. I understand that, but I want to reemphasize it. We are in the rulemaking process for the appeals rule. We are working with OMB on expediting the completion of that. And I hope to have that completed next month.

Senator SARBANES. All right. I know my time is up, but I want to get one factual thing straight. You collect about $2 billion in premiums annually. Is that right?

Mr. MAURSTAD. About $2.2 billion in premiums and fees.

Senator SARBANES. And as I understand it, before we deal with this extraordinary situation we are now confronted with, you pay out about $1.2 billion in claims during an average loss year. Is that right?

Mr. MAURSTAD. It is probably closer to between $900 million and $1 billion, average, the last numbers that I got.

Senator SARBANES. Does that mean that you add $1 billion a year to a reserve in a normal year?

Mr. MAURSTAD. No, sir. The balance goes for the reimbursement of the write-your-own companies, for their administering the program on behalf of the Federal Government. It goes to support the Federal Insurance Administration budget, operational budget. And it goes toward some grant programs such as the flood mitigation assistance grants, and there has historically been about $40 million that has gone toward the mapping efforts, which was woefully inadequate, and the reason why we recommended and Congress along with our mapping coalition partners proposed the flood map modernization effort a couple of years ago, the $1 billion, 5-year program.

Senator SARBANES. Leaving aside the flood mapping, which, as you said, was $40 million, are you laying out about $1 billion a year in order to sustain a system that pays $1 billion in claims? Is that right?

Mr. MAURSTAD. Well, that would be the case.

Senator SARBANES. That is a pretty high ratio, is not it?

Mr. MAURSTAD. Again, if you are looking at the average loss year, in those years where there——

Senator SARBANES. You take in $2 billion in premiums.

Mr. MAURSTAD. Excuse me?

Senator SARBANES. You take in $2 billion in premiums.

Mr. WALKER. Yes, sir.

Senator SARBANES. You pay out $1 billion in claims, roughly speaking.

Mr. MAURSTAD. Yes, sir.

Senator SARBANES. And, roughly speaking, you use up the other $1 billion to sustain the infrastructure to pay out the $1 billion in claims. Is that right?

Mr. MAURSTAD. That would be an accurate assessment.

Senator SARBANES. What are we to think of that ratio? What does the Comptroller think of it?

Mr. WALKER. Senator Sarbanes, I think it would be a good idea for us to take a look at these ratios as compared to other insurance programs and report back to you on it.

Senator SARBANES. Yes, absolutely.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

I am just going to continue on Senator Sarbanes questions. It has been 19 months—19 months—since the President signed the 2004 Act and over a year since the law's deadline to implement the reforms that were in that Act. Three months ago, you did not have an answer to this question, so I ask it again. And you kind of answered Senator Sarbanes. Are you telling me for sure that this will be implemented within a month or two?

Mr. MAURSTAD. It is my hope and I am making a commitment to you that we have this rule published hopefully sometime next month.

Senator BUNNING. I am sure glad that the rest of the Federal Government does not work that poorly because that is just not acceptable.

How has the response to last year's hurricanes affected the program's ability to respond to other floods not in the hurricane area?

Mr. MAURSTAD. We have been able to continue, maintain providing flood claims, the payment of flood claims throughout the country because we rely on the 96 write-your-own companies who administer this program on our behalf and use their structure by which to issue the policies, adjust the claims, and make the payments. There is no question that the back-to-back catastrophic years have not only stressed the fund, but also our human capital resources also. But we continue to serve all 4.7 million policyholders because of the partnerships that we have developed with private industry.

Senator BUNNING. You said in October when you were here that you were providing advisory information to the Gulf region on how to rebuild and reduce future damage. Can you elaborate on that?

Mr. MAURSTAD. We have worked with the mapping partners and the engineers in the Gulf Coast area and developed advisory base flood elevations for the three coastal counties in Mississippi and 11 of the 15 parishes on the coastal area in New Orleans—I mean in Louisiana, to assist decisionmakers in how best to rebuild. Those advisory base flood elevations, of course, have higher elevations than what——

Senator BUNNING. Are they paying any attention to your advice?

Mr. MAURSTAD. Yes, I believe that they are. In fact, part of my visit to the Gulf Coast, the Mississippi Gulf Coast area the week before last was to meet with the area mayors, area county representatives, banking industry, insurance industry. This was the topic of discussion. They had a lot of very good questions on what these advisories and their adoption of them or not at this point would mean to their rebuilding efforts. So, I do believe they are paying attention to them. A handful of the communities have adopted them, maybe a third of them in the Mississippi area. Other communities and counties are actively having meetings on it, part of their council meetings.

I would say they are paying attention to them. Have they all adopted them? No. Do we continue to encourage them to do so? Absolutely.

Senator BUNNING. One of the things that this Committee is going to have to decide is premium versus payout, and if we are paying out $1 billion to run a $2 billion program, we better look at the program.

There should be built into the Flood Insurance Program some type of reserve, and that would obviously go with premium increases and better mapping on where repetitive losses continue to mount up, and we do not charge the proper premium, obviously, in those areas. That was what was in the 2004 bill, and if it would have been implemented, particularly those people who need an appeals process because we had a lot of complaints about not being able to appeal a decision FEMA made, and if that was implemented more quickly, it would have been able to have been done a lot easier and with a lot less pain.

So, I suggest that when this Committee considers the new changes that we are going to have to make, Mr. Chairman, that we consider some type of reserve system.

Chairman SHELBY. Absolutely.

Senator BUNNING. And we are going to have to look at repetitive loss again.

Thank you very much.

Senator SARBANES. Mr. Chairman, if Mr. Maurstad does not meet the target dates he gave us, maybe we should start thinking now of another hearing to give him the opportunity at that point, not too far in the future, to explain why those target dates were not met.

Chairman SHELBY. Senator Sarbanes, we are going to bring our panel back, I am sure, more than once, because this is a very important issue for this Committee, and we are going to be thorough about how we approach it, because it cannot be done in a slipshod way in any way.

Senator SARBANES. That is fine.

Chairman SHELBY. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Maurstad, just for my own edification, this 100-year floodplain is a bit of a misnomer, is it not? It is not that an occurrence will happen possibly once every 100 years, but that the likelihood of exceeding the 1 percent, meeting or exceeding 1 percent of the elevation, is that not it?

Mr. MAURSTAD. Actually, sir, it is an indication that a particular property has a 1 percent chance in any given year of having a flooding event.

Senator MENENDEZ. So it could happen multiple times?

Mr. MAURSTAD. Certainly can and certainly does.

Senator MENENDEZ. Let me ask you, listening to my colleagues on the Committee ask you about the implementation of the 2004 Act, on the whole issue of the pilot program that was set under the Act on repetitive loss property, I think it was severe repetitive loss properties. Is that also not advanced?

Mr. MAURSTAD. That is not completed. We have done some of the provisions. We had the consultation meeting that was required. We provided the report on the appeals process within the repetitive loss pilot program. We have provided that. We are in the process of developing the rules and the regulations associated with that. We now have, as a result of the last appropriations bill, the funding available to implement that program. So we are in the rulemaking process, developing that program and hope to have that ready to go by the end of this fiscal year.

Senator MENENDEZ. By the end of this fiscal year?

Mr. MAURSTAD. Yes, sir.

Senator MENENDEZ. The rule that you are promoting is not promoted yet?

Mr. MAURSTAD. Which? On the repetitive loss?

Senator MENENDEZ. Yes, on repetitive loss.

Mr. MAURSTAD. No, that has not been published yet. We are still in the development process of that.

Senator MENENDEZ. What is your estimate of when it will be published?

Mr. MAURSTAD. On the Severe Repetitive Pilot Program, that is the one that will be by the end of this fiscal year.

Senator MENENDEZ. By the end of the fiscal year. So that means that the program itself will not actually take place until the next fiscal year?

Mr. MAURSTAD. Well, we hoped—again, there are some of these—the ability to give you a firm answer is in some cases outside my complete control. Our target is to get the program in a final rule by the end of this fiscal year. We want to do it as soon as possible. We want to get the program up and rolling and working with our States and community partners to get this program started as soon as possible now that we have the funding to do so.

Senator MENENDEZ. Do any of the panelists have any information on the proposal to extend to a 500-year plain, what that means? Is there any quantitative element of that? How many people would be captured by it? What would be the possible average cost?

Mr. WALKER. Part of the difficulty, Senator, is, as was mentioned by Senator Dole previously, not all of the States have up-to-date floodplain maps with regard to the 100-year requirement. By extending it to 500 years, you are going to need more information on in order to be able to make an informed judgment. I am not sure whether or not the Director may have some information that we may not be privy to but that he might be able to share with you.

Mr. MAURSTAD. Sir, we have a targeted range, we do not have a specific number. Somewhere in the neighborhood of impacting 4 to 6 million households.

Senator MENENDEZ. And do we have any sense of what the average cost would be for those individuals?

Mr. MAURSTAD. They would be, as far as the premiums that would be paid by those individuals, would be the lower risk rates, so I would think that they would be more in the neighborhood of $150 to $200 range, would be an estimate off the top of my head.

Senator MENENDEZ. And based upon the control time, it would, the updating of the maps, be a necessary prerequisite to be able to do that?

Mr. MAURSTAD. Our ongoing map modernization that I talked about earlier, where we have mapped about 42 percent of the population at this point into the third year of the program, and so there would certainly be additional resources to map a 500-year, as opposed to the 1 percent annual chance. So there would need to be some considerations made on our mapping, digitizing all of the flood maps.

Senator MENENDEZ. Finally, Mr. Marron, let me just ask you. You talked about that there is two ways of making this actuarially sound, raising money or driving out risk in the process.

Mr. MARRON. Yes.

Senator MENENDEZ. When we drive out risk, that has other consequential factors to it, does it not, both, obviously, to the individual—-they make that choice—but if they make the wrong choice at the end of the day, we are either facing, if they get hit with a flood, a very costly consequence. Either they have the resources to deal with the consequence or they could lose their property, and that also has a consequence to municipalities in terms of ratable basis, right?

Mr. MARRON. Oh, absolutely. If people do not have the insurance and a bad event hits, they are going to face exactly the losses you described, and then there will be carryover impacts on the communities in which they live, and just to be clear, there may be impacts on the Federal budget to the extent to which that creates a political demand for some assistance to them.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Allard.

Senator ALLARD. It seems to me that an important part of our Flood Insurance Program is our mapping. I view it as a foundation, and if we do not get that foundation firmly I place, I think it is very difficult for us to make good decisions. For example, a question was just asked about the 500-year floodplain, and how people are going to be impacted. I know we have the technology to do the mapping. The question I have is, what is the average age of the flood maps that are currently being used?

Mr. MAURSTAD. I think prior to the map modernization effort that started a couple of years ago, the average map was 15-plus years old on average, some less, many more, depending upon how high risk of an area that we would be talking about. We have been focusing on the highest risk areas first as we started this 5-year program.

Senator ALLARD. I have run into some areas in Colorado that have not been updated in 50 years, and the local governments cannot make decisions about floodplains because they are not updated. So the question comes up, how do you decide which areas you are going to update, and how do you establish priorities? I would like to have a response to that question.

I have another question concerning your statement that maps for 42 percent of the population have been updated. What percent of the geographic area of the United States has been mapped? To me that is a more pertinent question than percentage of population.

Mr. MAURSTAD. We can provide you with the mapping implementation plan that has been developed and updated, but structurally, as you recall, when I was Regional Director for Region VIII and worked with the State of Colorado, we worked very closely with each of the States. They develop mapping plans according to the resources that are available by region. They do that using the plans that are developed at the local level. We have developed this from the local level up through the States to an overall Federal approach. So, I can get you what the current implementation plan is, which States, which counties are getting what map mod funding now and the balance of the program, so that you will be able to see how Colorado stacks up.

Senator ALLARD. Do these local governments have to provide money to get this going, or is it just providing information?

Mr. MAURSTAD. Initially, we provided funding to the States to assist in the development of the planning documents to utilize and assist the local communities. Different States approached it differently. We heard of North Carolina earlier, an approach they have taken, very aggressive program. But right now, we are in the process of developing the maps, and that is being funded by the Federal Government.

Senator ALLARD. And who does the mapping? Is it contracted out or is it done by the Agency?

Mr. MAURSTAD. Again, it is done differently, depending upon what part of the country. In your area we have a very active, cooperative technical partner—that is what they are called—who work with contractors, who work with the State and the communities to develop the approach and develop the tools.

Senator ALLARD. I have taken a lot of interest in the mapping. There are companies, and some agencies of the Federal Government, that will take an overhead, aerial photo, taken about 34,000 feet, plus the GPS system, plus the old USGS maps, and they will merge those all together in a program and come up with extremely accurate maps. In fact, they find many errors in the old USGS maps. I would hope that we are utilizing that type of technology. Then the remapping, once you get everything in place, should move along fairly rapidly. What is it that we can do to get these maps more current in a speedy fashion so that the information that we are getting is also more accurate?

Mr. MAURSTAD. Right now we are aggressively implementing the current authorization of the $200 million a year for 5 years in developing new Digital Flood Insurance Rate Maps for the country based on the priorities that were developed in working with the States and the locals.

Back to your question earlier, 75 percent of the maps are more than 10-years-old, and that is why Congress recognized that we needed to do this map modernization project. It is very important, one of the three legs of this NFIP stool. The plan is online, but would be more than happy to meet with you and visit with you on how the mapping is under way in the State of Colorado.

Senator ALLARD. Thank you.

Mr. WALKER. Senator, may I intervene?

Senator ALLARD. Go ahead.

Mr. WALKER. I think this is a critically important issue. We have obviously had a number of significant subsequent events. There is a real need to update these maps. In my lifetime, I have lived on one property that was on 100-year floodplain that did not flood, and another one that was not on a 100-year floodplain, and it did flood. So, I think it is very important that this be done. I guess the real question is, is this a money problem and/or a capacity problem? I do not know the answer to that, but it seems to me that the need is clear and compelling.

Senator ALLARD. Mr. Chairman, just one additional question?

Chairman SHELBY. Go ahead.

Senator ALLARD. Is the program that we have in place now with the $200 million, adequate to complete remapping within the 5-year plan that you mentioned?

Mr. MAURSTAD. We have the $200 million, plus the NFIP continues to have $40 million, plus there are resources that are put in by those States or local communities that have information or data to share with the program. We are learning, as we get into the program, and we are working with the Department on determining whether or not additional resources will be needed beyond the current 5-year period to make sure that we adequately do what Congress is looking for in this program.

Senator ALLARD. Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Mr. Marron, I will direct this question to you. If the Flood Insurance Program had started on a actuarially sound footing, do you have any sense of what the current reserves would have been pre-Katrina?

Mr. MARRON. I am sorry, no, we have not done that calculation, but we could and follow up.

Chairman SHELBY. Would you follow up with that for the record?

Mr. MARRON. Absolutely.

CBO cannot determine with precision the additional money that would have been collected if all premiums for flood insurance had been actuarially based since the inception of the program, in large part because actuarial premiums would have significantly reduced participation in the program by individuals and communities. As noted in the testimony, the peer-reviewed study of demand for flood insurance estimated that the price elasticity for dollars of coverage is -1.0, which would imply that coverage falls enough in response to price increases to leave total premiums unchanged. In that case, the benefit to the program of higher premiums would have taken the form of reduced risk exposure and lower payouts, not higher premium income. Note, however, that the elasticity estimate was derived from data on the effects of relatively small price increases that did not lead whole communities to drop out of the program; had all premiums been actuarially sound from the outset, it is likely that fewer communities would have decided to participate, and hence that the program would have lost some of its unsubsidized policies as well.

FEMA staff have given CBO a rough estimate that the subsidies provided in the NFIP over time have cumulated to between $15 billion and $18 billion, measured in today's dollars. FEMA's calculation reflects the simplifying assumption that the current premium shortfall on subsidized policies applied to policies sold in past years. The net impact of that assumption is unknown: Past policies carried smaller coverage limits, on average, but were more heavily subsidized in percentage terms. In any case, FEMA's calculation overstates the amount of additional revenues the NFIP could have taken in under full actuarial pricing, because it does not take into account the fact the volume of coverage sold would have been lower under such pricing. For the reasons noted above, the improvement in the program's actuarial balance from actuarial pricing would have been split between increases in premium income and reductions in payouts on flood losses.

Chairman SHELBY. I will direct this question to Mr. Walker at GAO. Could you explain to the Committee how the current mandatory coverage requirements applies to a particular home? Should we consider expanding the mandatory coverage to other homes within the 100-year floodplain, such as those with non-Federal mortgages?

Mr. WALKER. Senator, my understanding is that individuals who have a mortgage from a Federal regulated lender, and who are within the 100-year floodplain, are required to buy flood insurance up to the extent of their mortgage, capped at $250,000.

Chairman SHELBY. How is that program implemented? How do we know they do it? It might be a requirement, but is it actually done?

Mr. WALKER. Obviously, the lender has a direct incentive to make sure that it is implemented, because it serves to protect them from loss. But one of the issues that was raised before by Senator Carper, was whether and to what extent that money is required to be escrowed to make sure that the premiums are paid and the coverage is in place.

As you know, Senator, there are individuals who do not have a mortgage and who are in a 100-year floodplain. In fact, some very poor people who may have a home that has been in their family for generations, such as New Orleans, who do not have a mortgage, are not required to have flood insurance, and they may not purchase flood insurance. Furthermore, if an individual obtains a mortgage from a non-federally regulated lender, they are not required to have insurance.

Chairman SHELBY. It is my impression, Mr. Marron, to go back to you, it is my impression that many of the homes currently receiving explicit subsidies are second homes. Does the CBO, the Congressional Budget Office, have an estimate of how many second homes are currently receiving subsidies under the Flood Insurance Program, and would eliminating second-home subsidies, what would that bring to the program?

Mr. MARRON. Again, that is not an estimate that we have done.

Chairman SHELBY. Would you run some numbers on that?

Mr. MARRON. Be happy to see what kinds of—and I should actually have placed this as a caveat on my previous answer—we will see what numbers are available to give you responsive answers.

Senator SARBANES. Doesn't FEMA have those numbers, Mr. Maurstad?

Mr. MAURSTAD. We have—yes, sir.

Senator SARBANES. On primary residences and nonprimary residences?

Mr. MAURSTAD. The nonprimary-nonresidential subsidized properties would contribute about $50 million annually more, and the other than primary residences would be about $200 million if they were actuarially risk-based rated.

Mr. WALKER. I think that is an important point.

Senator SARBANES. Yes. But I think the question was what percent of the flood insurance on homes that are primary residences——

Chairman SHELBY. Second homes.

Senator SARBANES. And second.

Chairman SHELBY. Do you have that number? I will ask the question again, just for the record. Does the Congressional Budget Office have an estimate of how many second homes are currently receiving subsidies under the Federal Flood Insurance Program? In other words, how many second homes? You say you do not have that.

Mr. MARRON. We do not have that at the moment.

Chairman SHELBY. But you will get that information.

Mr. MARRON. We will see what data is available, yes.

According to data provided by FEMA, about 363,000 of the 1.2 million subsidized policies as of December 31, 2005, or 30 percent, are for properties identified as residences other than principal residences. Those subsidized non-principal residences include 180,000 (15 percent of all subsidized structures) for single families, 41,000 (3 percent) for two to four families, and 142,000 (12 percent) for more than four families. The 30 percent share is consistent with the fact that non-principal residences account for 31 percent of all NFIP policies, subsidized and non-subsidized. The remaining subsidized structures include 765,000 (63 percent) principal residences, 76,000 (6 percent) commercial structures, and 11,000 (1 percent) residences that the data do not identify as principal or non-principal.

Chairman SHELBY. Mr. Walker, do you have that information at GAO.

Mr. WALKER. I do not, but I think it is very important. It comes back to what I said before.

Chairman SHELBY. Very relevant.

Mr. WALKER. Yes, I think it is very relevant. I mean, what is the purpose of this program? To the extent it is a primary residence is one thing. To the extent it is a secondary residence, it is another, and what are the financial means of the individuals involved?

Chairman SHELBY. Would you look into that too? I know you all will collaborate.

Mr. WALKER. We will collaborate.

Chairman SHELBY. Collaborate on that.

Mr. Marron, going back to you, Congressional Budget Office. In numerous portions of your written testimony you state the importance of scoring the Flood Insurance Program on the budget. We know what you mean by scoring, and most people do, but maybe the American people do not. Could you elaborate on why it is so critical to score the Flood Insurance Program on the budget, and what do you mean by scoring?

Mr. MARRON. Sure. If I could just step back. In thinking about our budgetary institutions, there are two key issues. One is how we reflect programs like this on the reported budget so that we can see it in the historical data. And then there is the process that CBO is engaged in of forecasting or projecting what a baseline budget might look like in the future.

And then scoring is the activity of evaluating proposed legislation against that baseline.

Chairman SHELBY. As to the cost, right?

Mr. MARRON. Yes, as to cost.

Chairman SHELBY. So future cost to the taxpayer?

Mr. MARRON. Exactly.

Mr. WALKER. Mr. Chairman, a key point is part of the problem is the way we keep score. In many cases, we are keeping score on a cashflow basis, based on 1-year, 5-year, or 10-year horizons, rather than on a discounted present value accrual basis. One example of that is it is not just with regard to insurance programs, but the Federal overall budget. The overall deficit last year on an accrual basis was several hundred billion dollars higher than was publicly reported because of how we keep score, and that is part of the problem.

Chairman SHELBY. So scoring is important, and how you keep that score is very important; is that correct, Mr. Walker?

Mr. WALKER. I agree.

Chairman SHELBY. Mr. Marron, do you agree with that?

Mr. MARRON. Absolutely.

Chairman SHELBY. Mr. Maurstad, I am not going to leave you out.

Mr. MAURSTAD. Thank you, sir.

Chairman SHELBY. One of the primary purposes of the explicit subsidy of preflood insurance, homes, that is, houses built before the completion of the Flood Insurance maps was to minimize the financial burden on families that were then residing in flood-prone areas. Is there any change in the level of subsidized rates when one of these pre-FIRM property, pre-Flood Insurance is sold? In other words, does it remain the same?

Mr. MAURSTAD. It does remain the same.

Chairman SHELBY. Why is that? It looks like that could be another risk there.

Mr. MAURSTAD. I believe that is the way that the current regulations are. I think it goes back to when the program was designed initially. There was a feeling that over time, maybe 50 years, these pre-FIRM structures would move on, so to speak.

Chairman SHELBY. Disappear?

Mr. MAURSTAD. Disappear. And that has not occurred at the rate that was anticipated back 37 years ago. Part of it is also when homes are substantially damaged, or are damaged, that there is a desire to try to keep the damage under our 50 percent requirement of updating those homes so they can stay as they are. So there are a number of factors that involved as to why those structures are still with us.

But if I could ask, sir, I have some numbers on our operating budget. If I could provide those to you?

Chairman SHELBY. Could you furnish that? I know Senator Sarbanes posed that question, but we are all interested in that.

Mr. MAURSTAD. Okay. The $2.2 billion income is broken down in this fashion. About $1 billion is set aside for the average loss year claims; $650 million for the write your company expenses claims processing; $200 million for operations, the mapping that we talked about, the Flood Mitigation Assistance Grant Program; and then about $350 million for reserves to assist the program in those years where there is what I would guess you could define, given last year's event, as minimum fluctuations in the program and the ability to have a small amount of reserves set aside to help through those ups and downs in those years, along with the borrowing authority that allows us to go through those nonaverage claim years. So that is how that $2.2 billion is broken down.

We will look at, working with you, in assessing whether that needs to be——

Chairman SHELBY. Would you furnish for the record the details of that?

Mr. MAURSTAD. Yes, sir.

Mr. WALKER. Mr. Chairman, just based on the numbers, that is an over 40 percent administrative expense ratio.

Chairman SHELBY. That is high.

Mr. WALKER. Most of that is paid to the insurance companies, I might note.

Chairman SHELBY. We would like to know where that money goes, would you not, Senator Sarbanes?

Mr. WALKER. We will get that to you, sir.

Chairman SHELBY. One last question here. The Flood Insurance Reform Act of 2004 established a mechanism for addressing worse properties, so to speak, which have suffered repetitive flood losses. These repetitive loss properties represent, I believe, a significant drain on the Flood Insurance Program. Should the program, as we get into reforming it, continue to insure any eligible property regardless of how much we have paid on it? Mr. Walker? In other words, you have areas that you know are going to be at high risk over and over.

Mr. WALKER. Senator, it comes back to what I said before. I think you have to look at what is the nature of the area, what is the nature of the development and the population of the area, and what are the means of the individuals there.

Chairman SHELBY. We understand all that risk because a lot of us, including my State of Alabama, we have a lot of that risk there. We were very lucky. But look at all States with a big shoreline, subject to hurricanes and everything that goes with it. Go ahead.

Mr. WALKER. I think the program has to be targeted much more as to who is covered, to what level, and it also has to be risk related to a much greater extent with regard to the premium structure than it has been previously.

Chairman SHELBY. But if it is risk related, that would tend to make it more actuarially sound, would it not? There is a correlation there.

Mr. WALKER. It would. The NFIP still has a huge accumulated deficit that is going to have to be dealt with. The accumulated deficit right now is about $23 billion. The question is, can you make this program actually sound on a go-forward basis, and service the debt or not? There are a lot of issues here that have to be looked at. It is actuarially sound from here forward, but what about the $23 billion sunk cost and the related accumulated interest costs.

Chairman SHELBY. I would be curious when that is going to be paid off too and how.

Senator Sarbanes, do you have any further questions?

Senator SARBANES. Thank you very much, Mr. Chairman.

I want to try to get this in some context and address some of these concepts. The hurricane that hit the Gulf Coast and New Orleans was of an order of magnitude that far exceeded anything we had ever experienced; is that correct? What is that order of magnitude? You are talking now about $24 billion, as I understand it. You have borrowing authority for $18½ billion. You want another $5½ billion, which you think will meet all legitimate claims. That is your estimate, although we will see what carries through, but that is your estimate. So you are shy $5½ billion borrowing, but that is a $24 billion bill for this hurricane, or two hurricanes, whatever. Now, how does that compare with previous hurricanes?

Mr. MAURSTAD. It far exceeds the magnitude of any individual event that has ever occurred.

Senator SARBANES. What is the largest previous event of a hurricane flooding?

Mr. MAURSTAD. The largest season would have been 2004, the cumulation of the four hurricanes of 2004 which produced about $2 billion——

Senator SARBANES. Two billion?

Mr. MAURSTAD. —$2.2 billion in losses.

Senator SARBANES. All four added together?

Mr. MAURSTAD. Correct, during 2004. The magnitude of this storm——

Senator SARBANES. So that is one-tenth of this.

Mr. MAURSTAD. That is correct.

Senator SARBANES. I just want to make this observation. I think there is a danger in addressing the basis program in the context of these kinds of figures because I do not see any rational program that you could put into place that would provide actuarial soundness against this amount of damage, as I understand it. Let me give you an example.

As I understand it, if you get the borrowing authority and you go up to those figures, the interest cost on that borrowing authority is going to cost you close to another billion dollars a year, is that right?

Mr. MAURSTAD. Yes, sir.

Senator SARBANES. You are getting $2 billion in revenue now, so that means just to cover the interest on the borrowing, you would have to increase your revenues from where they are now by another 50 percent. Is that correct?

Mr. MAURSTAD. Yes, sir.

Senator SARBANES. And that does not make any provision for repaying the principal; is that correct?

Mr. MAURSTAD. I believe that is why the Chairman indicated the program was bankrupt.

[Laughter.]

And why structural, meaningful reform is needed now.

Senator SARBANES. Yes, but the question is, are you going to set out on a challenge of reform that would encompass the capacity to handle a storm of this magnitude? And if you set out on that path, you would have to increase your revenues 10 times over, so you are going to jump the insurance 10 times—well, I mean these are rough calculations, but I am just trying to get this in some perspective.

I think we have two problems. One is, how do we address this tremendous catastrophe, far exceeding anything we ever experienced, and we have a real problem there. And then the other is what do we do about—and it helps to highlight some of the problems, but it does not answer. The other is, what do we do to the system in order to strengthen it and to make it work better?

Mr. WALKER. Senator, I agree with you wholeheartedly. My point is you should look at the sunk or legacy cost, $23 billion, most of which is directly attributable to the recent catastrophic events dealing with Katrina and Rita.

Chairman SHELBY. It could be more, could it not?

Mr. WALKER. It could be more. But you are starting off deeply in the hole. I think you have to do several things. One, you have to figure out what does it make sense to do with the Federal Flood Insurance Program from this point forward in order to provide reasonable but not absolute assurance that it can be actuarially sound with regard to activities from this point forward. That is a separate issue from what you should do about that $23 billion. You have to decide whether and to what extent you want to cover the cost of that $23 billion and/or the related debt service cost as part of your reform package through the insurance program, or whether or not you want to deal with that some other way.

Senator SARBANES. If you try to do it through the insurance program, you are imposing an incredibly heavy burden. I do not even think if you leave that out that through the insurance program you could make adequate provision going out into the future to handle a natural catastrophe of this magnitude. It just exceeds whatever is within the ball park as a reasonable way to try to deal with this.

Mr. WALKER. I would respectfully suggest that you are going to need to deal with the legacy cost separately. Then you are going to need to look and decide how best to proceed with this program going forward. You may not be able to adequately fund for an event like Katrina happening again, but clearly, we can do much better than we have.

Senator SARBANES. I think that is an appropriate observation. Let me ask you this question, because we are compounding the complexity of this by introducing this 500-year floodplain. I am not clear that we have fully explored the application of 100-year floodplain in terms of helping to strengthen the program.

Let me ask just a couple of questions on that score. At the moment, if you have a mortgage from a federally regulated financial institution, you must have flood insurance if the home is located in 100-year floodplain, correct?

Mr. WALKER. Up to the value of the mortgage, capped at $250,000.

Senator SARBANES. Right, which is another limitation. What percent of the homes that are covered by that application have flood insurance?

Mr. MAURSTAD. I believe there was a recent study—recent, within the last 5 years—that would indicate that in the neighborhood of 40 to 60 percent of the homes——

[Pause.]

Senator SARBANES. Are you straightening something out down——

Mr. WALKER. I was trying to understand whether the 40 to 60 percent was the percentage that were required to have it that had it.

Senator SARBANES. Yes, that is what I am asking.

Mr. MAURSTAD. That gets at the heart of the effectiveness of the mandatory purchase by the lenders, and, again, all I can do is share from recollection—I will try to find the exact study for you—that in the neighborhood of 40 to 60 percent of those that should have it under the mandatory purchase do. But it has been an issue that has not been thoroughly studied and for which there are differing opinions.

Senator SARBANES. So about half of the ones that are now required to have it—and that is a limited universe of all of the houses in the 100-year floodplain. But about half of those have it. Is that correct?

Mr. MAURSTAD. Again, my recollection, I think GAO has done some look at this in the past and maybe in their recent reports have indicated that they have not been able to develop a definitive answer to that, but I do not want to speak for GAO.

Senator SARBANES. Again, doing a rough calculation, because it is affected by the value of the house and so forth, but presumably if 100 percent had it instead of 50 percent, you would double the money coming in, roughly speaking. Is that correct?

Mr. MAURSTAD. If those premises are accurate, yes.

Senator SARBANES. Yes, and this is required under existing law. So we are only getting 50 percent of the required money. Now, that does not address the question of being in a 100-year floodplain and having a mortgage from a non-federally regulated financial institution or having no mortgage at all.

Now, just one final point, Mr. Chairman.

Chairman SHELBY. Go ahead.

Senator SARBANES. The subsidized payments, as I understand it, go to homes that were in the floodplain before 1974. Is that right?

Mr. MARRON. Before the community's flood rate now.

Mr. MAURSTAD. Right, before the community adopted their existing flood insurance rate map.

Senator SARBANES. I see. So if those homes seek flood insurance, they get a subsidized rate. If you put a house into the floodplain after and you want flood insurance, you have to pay the actuarial rate. Is that correct?

Mr. MAURSTAD. You cannot put a house into the floodplain after the flood insurance rate maps are adopted unless they are at the adopted base flood elevation by the community. And then they would not be in this pre-FIRM category.

Senator SARBANES. And do those homes pay an actuarial rate?

Mr. MAURSTAD. Yes. On new construction, on construction of substantially damaged homes, and on construction of substantially improved homes that are built at the base flood elevation are higher, they pay actuarial rates and that is why the number of subsidized homes has been going down over the years. It has just not gone down at the rate at which it was initially intended.

Senator SARBANES. If I remodel a subsidized home, do I pay an actuarial rate or do I continue to get the subsidized rate?

Mr. MAURSTAD. If the improvement is more than 50 percent of the market value of the property, then you would pay the subsidized rate.

Senator SARBANES. No, I would pay the actuarial rate.

Mr. MAURSTAD. The actuarial rate. If it is more than 50 percent—I am sorry if I have been unclear. If you are substantially improving the home, more than 50 percent of its market value, you would have to elevate the current base flood elevations, and then you would not pay the subsidized rate. You would pay the actuarial rate, which would be less.

Senator SARBANES. It would be what?

Mr. MAURSTAD. It would be less.

Senator SARBANES. Less than what?

Mr. MAURSTAD. Less than the subsidized rate. The subsidized rates are actually more expensive than the risk-based rates, because they are more at risk, they are below the base flood elevations.

Mr. WALKER. But the cost to raise the property up to the standards could be substantial. In other words, what could be going on here—and I would ask the Director. He has the data. But what could be going on here is when you have a cliff like that, people could be making adverse selection decisions to decide whether or not, and to what extent to improve, in order to maximize their personal benefit.

Mr. MAURSTAD. As Mr. Marron indicated earlier, the average premium for subsidized is $700. The average rate for an actuarial rated property is $400. So even though that property is subsidized, they still pay a higher premium because they are the most at-risk properties. That is why they needed the subsidy.

Senator SARBANES. Are those the figures you use?

Mr. MARRON. Ours were slightly different but comparable with that, the average subsidized property at $710 and in our calculations the average unsubsidized property at $340, and for the reason that he mentions, that the subsidized properties are systematically more risky than the average.

Senator SARBANES. I see. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman. Thank you for holding this hearing. Like all of our colleagues, after Katrina and Rita I rushed up to Rhode Island, the Ocean State, and tried to make an assessment of what could happen if we received a hurricane of that magnitude. And what I discovered at one point was that the FEMA maps are out of date; 70 percent are over 10 years old. In my State of Rhode Island, they are 20 years old out of date. They do not incorporate the Army Corps of Engineers inundation maps, which might give certainly a fuller appreciation of potential consequences of a flood. And I came back and have introduced legislation, the National Flood Mapping Act of 2005, which I hope in our deliberations we can consider. It would first require a more rapid updating of these maps so that we are dealing with the present situation.

I do not think Rhode Island is alone, but in the last 20 years, much has changed on our coastline. Thousands of homes have been built. People are flocking there, as they are up and down the east and west coasts, and yet these maps do not reflect that kind of human intrusion and habitation. And we should make these maps accessible by putting them on the Internet so that everyone can see quite quickly where the lines are with respect to inundation floods, and standards for establishing maps should be more uniform, and also directly identifying those areas that could be affected by hurricanes, and certainly asking the Comptroller General to make recommendations about our policy along these coastlines in terms of building and development. I think that is essential, and I hope as we go forward we can grapple with these concepts embedded in this bill.

We know hurricanes are going to happen again in Rhode Island. Climatologists suggest that the lull in hurricanes that I have observed anecdotally since being a child in 1954 with Hurricane Carol is anticipated to pick up by many scientists, and we know it is coming. So, I think we have to make these improvements. I thank you again, Chairman, and the Members for their participation today.

Let me ask just one question, because I know that you have been here for a while, and that is to the Comptroller General. I am concerned about whether enough attention, staff, and funds have been provided to natural disaster and predisaster mitigation since FEMA became part of Homeland Security. You know, has GAO looked at the resource allocation and its potential impacts on State and local governments with this transfer?

Mr. WALKER. My understanding, Senator Reed, is the answer to that is no.

Senator REED. Could you elaborate? You have not looked at it?

Mr. WALKER. We have not looked at that specific issue. We have looked at many issues and we are looking at many issues dealing with FEMA, Katrina, and Rita, but not that issue. We would be happy to talk to you and the Committee.

Senator REED. I think it is important since we have heard in other contexts where agencies—not just FEMA but other agencies moved into DHS have found difficulty establishing their home and their funding sources and fulfilling their mission. So, I would ask you to look at that, and I would be happy to talk with you.

Mr. Chairman, let me stop at that point right now.

Chairman SHELBY. Thank you.

Senator CARPER.

Senator CARPER. Thanks, Mr. Chairman. We are really blessed with the witnesses that are before us today. This is a good panel, and I just regret that I could not be here for the whole thing. We have another concurrent hearing going on, on ethics and lobbying reform and stuff like that. So, I have been bouncing back and forth. You know how it works.

Let me preface my larger questions by making a request of Mr. Maurstad, and that would be just to ask you to share for the record how many homes in Delaware would be included in the 100-year and the 500-year floodplain. If you could do that for the record, I would appreciate it.

I want to go back to something that Senator Sarbanes was, I think, speaking to, and I just heard part of what he was saying. I understand that one of the reasons why a lot of people elect not to have flood insurance even though they are in a risky area is because their homes are paid for and there is no real requirement for whoever has provided the mortgage to stipulate that flood insurance be required.

But I think I heard Senator Sarbanes say something about in those places where coverage is required or mandated of homeowners, only about 50 percent of the homeowners actually have obtained the coverage. I think I heard him say that. If that is correct, why only 50 percent? Why aren't the other people getting the coverage as well?

Mr. MAURSTAD. I believe Senator Sarbanes was taking the estimate that I provided off the top of my head of between 40 and 60 percent. You know, why it is not more effective, again, anecdotally or what I have picked up when I have asked the same question is the amount is not escrowed and so the policy does not stay in force beyond the initial time that the mortgage was written. The mortgage may be sold to someone else, and during that period of time, the policy lapses. So there are a number of anecdotal—I also indicated that recollection tells me that there was some type of a study done on this within the last 5 years. I would like to see if I can discover that and provide it to the Committee if so. But, again, I believe that there have been attempts by GAO also in the past to be able to measure this, and they have not been able to get their thumb on it, as I recall. But I do not want to speak for the Comptroller.

Senator CARPER. Okay. Thank you.

Mr. WALKER. Senator, my understanding is that there is a massive data reliability problem here. I think one of the things that the Senate may wish to consider is, to the extent that you are dealing with entities that are mortgages that are issued by a federally regulated entity, if the major problem is that people may end up paying it in year one but not in later years, then you might require that these amounts be escrowed in order to assure that the premiums get paid on a recurring basis.

Senator CARPER. Thank you.

Mr. MAURSTAD. Sir, in addition, we work with our Federal partners in this area. The lenders, I believe, since they are not at the table, would indicate that they would believe that that percentage is higher than what I have characterized and believe that there is greater enforcement of that. It may be a good question. Maybe the lenders have done a study and they are aware of what these numbers are. But I do know—and it is what has been evidenced by this last storm, and it also came forward in the 2004 storms—that the unmet need of those that lacked insurance is greater than what people's expectations were. And many of those—although there has not been any number, many of those had to have mortgages. I know Congress is dealing with those unmet needs.

Another issue in addition to the escrowing amount that I believe we need to look at is instead of requirement of just covering the amount of the loan, we should look at providing insurance to value during that period of time so that people that also are finding themselves having a flood policy but not having an adequate limit would have had that mandatory requirement to have a limit that would insure them better at the time of the loss.

Senator CARPER. All right. Thanks.

Mr. Chairman, just one last question, if I could, and I would ask the panel if you would just be brief in responding to this. As I said earlier, we have very bright people before us on this panel, and I have not heard you testify. I have not heard everything. I heard part of your testimony, but not all the questions that followed it. Where do you agree? What are the basic areas you agree on in terms of the kinds of reforms that should be adopted? And what are the consequences if we do nothing more?

Mr. WALKER. I would respectfully suggest—and we will see if my colleagues agree with this—that the National Flood Insurance Program is $23 billion in the hole, primarily attributable to Katrina, Rita, and Wilma, because up until those events it was in reasonably good shape. Congress is going to have to decide how to deal with that $23 billion, which is a sunk cost. In addition to that, because of all that we have learned over the years, including Katrina, Rita, and Wilma, the program is going to need to be reformed in order to determine who should be covered, to what limits based at what rates, and whether or not escrow is appropriate, et cetera.

So, I think we are all saying there needs to be substantive and comprehensive reform going forward of the program, not just to allow them to borrow more money, but also how you are going to deal with that $23 billion negative number to start off with.

Mr. MARRON. If I could just build on that?

Senator CARPER. Sure, Mr. Marron.

Mr. MARRON. As David Walker said, a clear issue is the program appears to be—"bankrupt" is the word that has been used, and just as a matter of the physics and actualities of how you run the program, that will have to be addressed in some way, and obviously it is something that Congress will have to address.

If there are no significant changes to the program because of the subsidies that are built in, the program will continue to build up a fiscal hole. And that may or may not be apparent in coming years, depending on what storms hit us and what claims result. But over time we are building up that risk.

And then the third point I would just make is that because the Government has chosen to be in the insurance business, even if we moved to actuarially fair rates and so that on average we expect to break even, there is still a risk out there that we might get unlucky. And so that if all we do is move to actuarial fairness, there is still the possibility that things could turn out very poorly.

Senator SARBANES. Yes, but let's face facts. Is anyone positing that you can structure the Flood Insurance Program in a way that would enable you to cover, in some actuarially sound way, the costs of a catastrophe of the magnitude of Katrina?

Mr. WALKER. Not with a 100-percent probability, no. There are two issues. One, what do you do with the cost of Katrina? And, second, going forward, which you are raising, Senator, how do you recognize the fact that you can do a better job, but you will never with 100-percent certainty be able to cover those types of costs?

Senator SARBANES. Yes, I think you have to segment this out. First of all, the Flood Insurance Program is not working. Even if you left Katrina out, it was not working well. We addressed those questions to Mr. Maurstad, all the trouble people have, the appeals process and all the rest of it.

Second, going a step beyond that, it could do a better job of bringing in resources and building up its strength than it is doing now. We do not have 100-percent enforcement on the covered properties. Others should be covered. The flood maps have not been updated. On and on and on. You have to address the subsidized rate and so forth. So you could strengthen the program and its ability to handle hurricanes.

But the biggest previous hurricane was $2.2 billion. The four hurricanes added up together in 1 year. This is $24 billion. Now, you are not going to get the program up to the capacity of being able to handle $24 billion. You can do better so it can handle, you know, 3 or 4, whatever. I mean whatever is within reason. But beyond that, we are going to constantly face the problem of how do we address this kind of catastrophe when it happens. And then if you really address it, then you have an equity situation between people who did not get flood insurance and yet they get covered because you have this pressing human disaster, as opposed to the people who are paying out and getting flood insurance who can then say to you, well, I did not have to get this flood insurance, they would have taken care of me with this huge catastrophe that happened.

I have one final question. Mr. Maurstad, is the Administration going to submit to the Congress a statutory proposal for the reform of the Flood Insurance Program?

Mr. MAURSTAD. At this point in time, I believe that my testimony serves as the purpose for the——

Senator SARBANES. It is not a statute. Why don't you all—you are the experts, supposedly. I say that advisedly. You are the experts on the Flood Insurance Program. Why shouldn't it be part of your responsibilities here to send up to the Congress a proposed statute to reform the Flood Insurance Program? We may or may not agree with all of it, but it would give us a working basis.

Chairman SHELBY. It would be a proposal, anyway.

Senator SARBANES. Yes, it would be a proposal.

Senator CARPER. Mr. Chairman.

Chairman SHELBY. Senator Carper.

Senator CARPER. The witnesses never had a chance to really answer the second half of my question. I would ask you just very briefly, if you would, what are the consequences of our doing nothing further on this score?

Mr. MAURSTAD. I think that you certainly have the basis for what has occurred in the last 2 years repeating itself. We need to take this opportunity, as has been the case after other major events in the 37-year history of this program, for substantive, meaningful reform to occur post this type of an environment. There is not one thing that will solve the problem. It is going to take a number of initiatives to make the program stronger. We are going to need to look at is there a mechanism by which to structure the premium rates to have a component for reserve for catastrophe years such as this.

Another alternative may be like the private insurance market—

Senator CARPER. What I was asking, what are the consequences of our doing nothing? I was not asking you for a prescription of things we should do, but what are the consequences of our doing nothing? I am sorry.

Mr. MAURSTAD. Well, simply we would find ourselves in the same circumstance that we find ourselves now.

Senator CARPER. All right. Thanks.

Mr. WALKER. As Yogi Berra would say, "Déjà-vu all over again," and continuing some of the perverse problems that exist with the current program; and, third, further mortgaging the future of our kids and our grandkids.

Senator CARPER. All right. Thank you.

Mr. Marron.

Mr. MARRON. Exactly what the gentlemen said. We continue digging the hole, as I said earlier.

Senator CARPER. All right. Thanks. Thanks to each of you.

Thank you, Mr. Chairman.

Chairman SHELBY. Thanks for your question, but I do not think we have the luxury of doing nothing. This is public policy. This is very important.

I am just thinking out loud here. What have we learned here today, among other things? We have learned that the program is broken. It was never actuarially sound. We have real structural problems with the program. The flood mapping is grossly inadequate, the data reliability that goes into this. Should we, I believe one of you mentioned, insure value rather than just the mortgage? Because ultimately that is what people are interested in. And should we as public policymakers look at the people who are least likely and able to buy something because of their economic situation? As opposed to some of the very wealthy that have second, some third homes, and they are getting a ride, so to speak.

I think we have to make this as actuarially sound as we can. We have to look to the future. Senator Sarbanes asked a question earlier, and you all talked about sunk costs. I am afraid that cost might be sunk already, sunk with the taxpayer eating it. But we will have to see, but we are going to be comprehensive in these hearings, and we will hear from you again. And we hope that a lot of you are going to furnish information regarding the questions that we asked previously.

We appreciate your appearance, and you will be back, I hope. Thank you a lot. The hearing is adjourned.

[Whereupon, at 12:22 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR CHUCK HAGEL

Thank you Mr. Chairman for holding this hearing today on flood insurance.

In 2004, Congress passed legislation to reauthorize and reform our National Flood Insurance Program (NFIP). The goal of this legislation was to assist communities in preparing for floods and also make policyholders' premiums more equitable. I was an original cosponsor of this legislation in the Senate. Former Nebraskan Congressman Doug Bereuter introduced this legislation in the House. The President signed the bill into law on June 30, 2004.

The NFIP provides important protection for flood-prone communities across America. Given the impact of Hurricanes Katrina, Rita, and Wilma on the NFIP, Congress needs to examine the current fiscal state of the program and ask what can be done to improve it. We must look at ways to help flood prone communities better prepare for future floods and ensure that the program does not unfairly overburden the communities at low-risk for flooding.

Updating the flood insurance maps is important to helping achieve this and I am pleased by the Federal Emergency Management Agency's (FEMA) recent approval of the Letter of Map Revision (LOMR) for North Platte, Nebraska. This is not only good for the people in North Platte, but also good for fostering an equitable and strong flood insurance program.

Mr. Chairman, I welcome a very distinguished Nebraskan to today's panel. Dave Maurstad is FEMA' s Acting Director of the Mitigation Division. Dave also served Nebraska as a distinguished State Senator, mayor of one Nebraska's largest cities and as our Lieutenant Governor. I look forward to his testimony and the testimony of the other panelists. Today's hearing will help this Committee better understand the issues facing the NFIP and explore what can be done to improve the fairness and stability of the program.

United States Government Accountability Office

GAO

Testimony
Before the Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EST
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FEDERAL EMERGENCY MANAGEMENT AGENCY

Challenges for the National Flood Insurance Program

Statement of David M. Walker, Comptroller General of the United States

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Highlights

Highlights of GAO-06-335T, a testimony to the Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate

Why GAO Did This Study

The National Flood Insurance Program (NFIP), established in 1968, provides property owners with some insurance coverage for flood damage. The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security is responsible for managing the NFIP.

The unprecedented magnitude and severity of the flood losses from hurricanes in 2005 challenged the NFIP to process a record number of claims. These storms also illustrated the extent to which the federal government has exposure for claims coverage in catastrophic loss years. FEMA estimates that Hurricanes Katrina, Rita, and Wilma will generate claims and payments of about $23 billion—far surpassing the total claims paid in the entire history of the NFIP.

This testimony provides information from past and ongoing GAO work on issues including: (1) NFIP's financial structure; (2) the impact of properties with repetitive flood losses on NFIP's resources; (3) proposals to increase the number of policies in force; and (4) the status of past GAO recommendations.

What GAO Recommends

In past work, GAO recommended that FEMA strengthen its oversight of the NFIP and develop plans to implement requirements of the Flood Insurance Reform Act of 2004. FEMA disagreed with those recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-06-335T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William O. Jenkins, Jr., at (202) 512-8777 or jenkinswoj@gao.gov.

January 25, 2006

FEDERAL EMERGENCY MANAGEMENT AGENCY

Challenges for the National Flood Insurance Program

What GAO Found

The NFIP, by design, is not actuarially sound. The program does not collect sufficient premium income to build reserves to meet long-term future expected flood losses. In November 2005, FEMA's authority to borrow from the Treasury was increased from $1.5 billion to $18.5 billion through fiscal year 2008 to help pay claims from the 2005 hurricane season. It is highly unlikely that the NFIP as presently funded could generate sufficient revenues to repay a debt of this size.

One reason the NFIP is not actuarially sound is because a number of its policies on dwellings that were built before flood plain management regulations were established in their communities are subsidized and pay premiums of 35-40 percent of the true risk premium. In January 2006, FEMA estimated an annual shortfall in premium income of $750 million because of such policy subsidies. Some subsidized properties, called repetitive loss properties, also suffer repetitive flood losses, which accounted for about $4.6 billion in claims payments from 1978 to March 2004. We need to analyze the progress made to reduce the inventory of subsidized repetitive-loss properties and determine whether additional regulatory or congressional action is needed.

A challenge for FEMA is to expand the NFIP policyholder base by enforcing mandatory purchase requirements and encouraging voluntary purchase by homeowners who live in areas at lower risk of flooding. The extent of noncompliance with current mandatory purchase requirements for property owners in special flood hazard areas is unknown. There has been some congressional interest in the feasibility of expanding mandatory purchase requirements beyond the current special high-risk areas, however, there are a number of difficulties to assessing the impacts, effectiveness, and feasibility of such a change in the structure of the NFIP, as well as concerns related to enforcing and assessing compliance. For example, more precise flood mapping of areas outside the current high-risk areas would be required to accurately identify affected property owners. FEMA and its private insurance partners also have efforts underway to increase NFIP participation by marketing policies in areas where purchase is not mandatory.

FEMA has not yet fully implemented provisions of the Flood Insurance Reform Act of 2004 requiring the agency to develop new materials to explain coverage and the claims process to policyholders, establish an appeals process for claimants, and provide insurance agent education and training requirements. The statutory deadline for implementing these changes was December 30, 2004, and, as of January 2006, FEMA had not developed documented plans with milestones for meeting the provisions of the act, as recommended by GAO.

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to participate in today's hearing on the future of the National Flood Insurance Program (NFIP) to discuss issues related to the future financial stability of the NFIP and recommendations we have made for improvements to the management and oversight of the program. The NFIP combines property insurance for flood victims, mapping to identify the boundaries of the areas at highest risk of flooding, and incentives for communities to adopt and enforce floodplain management regulations and building standards to reduce future flood damage. The effective integration of all three of these elements is needed for the NFIP to achieve its goals of:

- providing property flood insurance coverage for a high proportion of property owners who would benefit from such coverage;
- reducing, through this insurance coverage, taxpayer-funded disaster assistance for property damage when flooding strikes; and
- reducing property flood damage through flood plain management based on accurate, useful flood maps and the enforcement of building standards (such as elevating structures).

Hurricanes Katrina and Rita represent a tragedy for hundreds of thousands of our fellow Americans. Their lives have been turned upside down, and many who would have benefited from flood insurance did not have it. This tragedy offers an opportunity to fundamentally rethink the flood insurance program and how it can best be structured to provide financial protection from flooding for those who need and would benefit from flood insurance while enhancing the program's financial foundation.

The Federal Emergency Management Agency (FEMA) within the Department of Homeland Security (DHS) is responsible for the oversight and management of the program.[1] Under the program, the federal government assumes the liability for the insurance coverage and sets rates and coverage limitations, among other responsibilities.

Floods are the most common and destructive natural disaster in the United States. According to NFIP statistics, 90 percent of all natural disasters in the United States involve flooding. However, flooding is

[1]In March 2003, FEMA and its approximately 2,500 staff became part of DHS. FEMA retained its name and individual identity within the department.

generally excluded from homeowner policies that typically cover damage from other losses, such as wind, fire, and theft. Because of the catastrophic nature of flooding and the inability to adequately predict flood risks, private insurance companies have largely been unwilling to underwrite and bear the risk of flood insurance.

The NFIP was established by the National Flood Insurance Act of 1968[2] to provide policyholders with some insurance coverage for flood damage, as an alternative to disaster assistance, and to try to reduce the escalating costs of repairing flood damage. In creating the NFIP, Congress found that a flood insurance program with "large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated."[3] In keeping with this purpose, FEMA has contractual agreements with 95 private insurance company partners to sell policies and adjust and process claims.

As of November 2005, the NFIP was estimated to have approximately 4.8 million policyholders in about 20,000 communities. According to FEMA, every $3 in flood insurance claims payments saves about $1 in disaster assistance payments, and the combination of flood plain management and mitigation efforts save about $1 billion in flood damage each year.

Flood maps identify the boundaries of the areas at the greatest risk of flooding. These areas are called special high-risk flood hazard areas, often referred to as the 100-year flood plain, that area in which there is a 1 percent chance of flooding each year, or a 30 percent chance of flooding over the period of a 30-year mortgage. Property owners whose properties are within the 100-year flood plain, as identified on the flood maps, and whose mortgages are from a federally regulated lender, are required to purchase flood insurance for the amount of their outstanding mortgage balance, up to the maximum policy limit of $250,000 in coverage for single family homes. The owners of properties with no mortgages or properties with mortgages held by lenders who are not federally regulated were not, and still are not, required to buy flood insurance, even if the properties are in the 100-year flood plain. Optional, lower-cost coverage is available under the NFIP to protect homes in areas of low to moderate risk that are

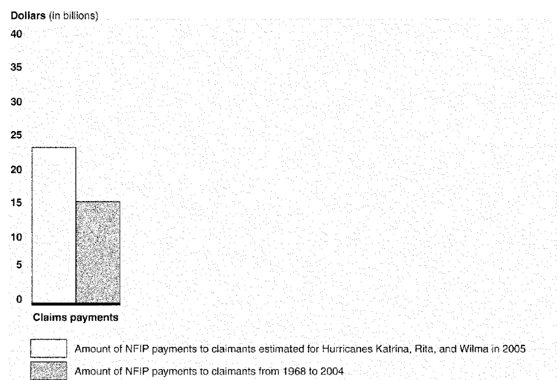
[2]The National Flood Insurance Act of 1968, as amended, is codified at 42 U.S.C. 4001 to 4129.

[3]42 U.S.C. 4001(b)(2).

outside the 100-year flood plain, but owners of properties in these lower-risk areas are not required to purchase flood insurance.

The unprecedented magnitude and severity of the flood losses in 2005 placed unprecedented challenges on the NFIP to process a record number of claims, many in properties flooded by Hurricanes Katrina and Rita that were inaccessible for weeks after the flooding occurred. These storms also illustrated the extent to which the federal government has exposure for claims coverage in catastrophic loss years. From its inception in 1968 until August 2005, the NFIP paid about $14.6 billion in insurance claims, primarily from policyholder premiums that otherwise would have been paid through taxpayer-funded disaster relief or borne by home and business owners themselves. As shown in figure 1, FEMA estimates that Hurricanes Katrina, Rita, and Wilma are likely to generate claims and associated payments of about $23 billion— far surpassing the total about $15 billion in claims paid in the entire history of the NFIP up to those events.

Figure 1: NFIP Claims Payments from 1968 to 2004 and Estimated for Hurricanes Katrina, Rita, and Wilma



Source: GAO analysis of FEMA data.

The NFIP cannot absorb the total costs of paying these claims. On November 21, 2005, FEMA's authority to borrow from the Treasury was increased from $1.5 billion to $18.5 billion through fiscal year 2008.[4] The acting director of FEMA's Mitigation Division said this borrowing authority will pay NFIP claims and expenses into February 2006, when additional legislative action to increase the borrowing authority will likely be required. He also said that it is highly unlikely that the program could generate sufficient revenues to cover a debt of this size. FEMA estimates that given its current income—about $2 billion annually—and average historical loss levels, it could expect to handle up to about $1.5 billion in debt and still have a reasonable chance to repay it within a 3- to 5-year time period.

GAO has a body of work underway on the preparation for, response to, and recovery from Hurricanes Katrina and Rita, including how the NFIP was implemented. We have had teams in the Gulf Coast states since the weeks immediately following the hurricanes collecting data and observations from hurricane victims and federal, state, local, and private participants in the preparation for, response to, and recovery from the extensive damages. I have also visited the region and spoken with governors in some of the affected states, military and civilian officials leading the recovery efforts, and others to help inform our work. One objective of the work we have underway on the NFIP is to assess what changes, if any, could be made to strengthen the NFIP's fiscal solvency. To this end, we will review proposals to increase revenues, reduce costs, or otherwise make the NFIP more actuarially sound. We expect to report on this matter later this year.

As GAO moves forward with this work, we will continue to coordinate with this and other congressional committees and the accountability community—federal inspector generals, state and city auditors—regarding the scope of our future work on emergency management issues, including the NFIP. Our goal is to apply our resources and expertise to address long-term concerns, such as those we are discussing today, and to avoid duplicating the work of others.

Past experience can provide context for considering future policy options. In this spirit, my testimony today is based on a body of work that GAO has

[4]National Flood Insurance Program Further Enhanced Borrowing Authority Act of 2005, Pub. L. No. 109-106, 119 Stat. 2288 (2005).

done over the past several years before the nation began the struggle to respond to the devastating effects of Hurricanes Katrina and Rita in our Gulf Coast states, as well as some preliminary results of interviews and review of documentation for work in progress on how the NFIP was implemented for these storms. Our prior work has addressed the issues of the program's structure and financing, oversight and management, repetitive loss properties, mandatory and voluntary purchase of flood insurance, and revising and improving the nation's flood maps. Together the prior work and work in process provide information useful in assessing efforts over the NFIP's history to enhance the program's financial stability and effectiveness. Most recently, we issued a report in October 2005 on FEMA's management and oversight of the flood insurance program that includes several recommendations for improvement.[5] This report was mandated by the Flood Insurance Reform Act of 2004.[6] It includes recommendations on two pre-Hurricane Katrina flood-insurance related issues that pose a challenge for FEMA. These are (1) improving FEMA's management and oversight of the NFIP and (2) improving FEMA's implementation of provisions of the Flood Insurance Reform Act of 2004 to provide policyholders a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that flood insurance agents meet minimum NFIP education and training requirements.

That report was based on interviews with FEMA officials, documentation of its monitoring and oversight processes, and our field observations of FEMA's monitoring and oversight activities. In addition, we analyzed the National Flood Insurance Act of 1968, as amended, its legislative history, and FEMA's implementing regulations, and we examined documentation and interviewed officials about FEMA's efforts to comply with provisions of the 2004 Flood Insurance Reform Act. We did our work from December 2004 to August 2005 in accordance with generally accepted government auditing standards.

[5]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).

[6]Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, 118 Stat. 712, 727 (2004).

Major Program Issues –a Summary

A key characteristic of the NFIP is the extent to which FEMA must rely on others to achieve the program's goals. FEMA's role for the NFIP is principally one of establishing policies and standards that others generally implement on a day-to-day basis and providing financial and management oversight of those who carry out those day-to-day responsibilities. These responsibilities include ensuring that property owners who are required to purchase flood insurance do so, enforcing flood plain management and building regulations, selling and servicing flood insurance policies, and updating and maintaining the nation's flood maps. In our prior work, we have identified several major challenges facing the NFIP:

- Reducing losses to the program resulting from policy subsidies and repetitive loss properties.[7] The program is not actuarially sound because of the number of policies in force that are subsidized—about 29 percent at the time of our 2003 report. As a result of these subsidies, some policyholders with dwellings that were built before flood plain management regulations were established in their communities pay premiums that represent about 35 to 40 percent of the true risk premium. In January 2006, FEMA estimated a shortfall in annual premium income because of policy subsidies at $750 million. Moreover, at the time of our 2004 report, there were about 49,000 repetitive loss properties—those with two or more losses of $1,000 or more in a 10-year period—representing about 1 percent of the 4.4 million buildings insured under the program. From 1978 until March 2004, these repetitive loss properties represented about $4.6 billion in claims payments.

- Increasing property owner participation in the program. The extent of noncompliance with current mandatory purchase requirements by affected property owners is unknown. Some interest has been expressed in Congress in assessing the feasibility of expanding mandatory purchase requirements beyond current special high-risk flood hazard areas. FEMA and its private insurance partners also have efforts underway to increase participation in the NFIP by marketing flood insurance policies in areas where purchase is not mandatory.

[7] GAO, *Flood Insurance: Challenges Facing the National Flood Insurance Program*, (GAO-03-606T (Washington, D.C.: Apr. 1, 2003); *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, (GAO-04-401T (Washington, D.C.: Mar. 25, 2004).

- Developing accurate, digital flood maps.[8] The impact of Hurricanes Katrina, Rita, and Wilma on homeowners has highlighted the importance of having accurate, up-to-date flood maps that identify the areas at risk of flooding and, thus, the areas in which homeowners would benefit from purchasing flood insurance. In our report on the NFIP's flood map modernization program, we discussed the multiple uses and benefits of accurate, digital flood plain maps. However, the NFIP faces a major challenge in working with its contractor and state and local partners of varying technical capabilities and resources to produce accurate, digital flood maps. In developing those maps, we recommended that FEMA develop and implement data standards that will enable FEMA, its contractor, and its state and local partners to identify and use consistent data collection and analysis methods for developing maps for communities with similar flood risk.

- Providing effective oversight of flood insurance operations. In our October 2005 report, we said that FEMA faces a challenge in providing effective oversight of the 95 insurance companies and thousands of insurance agents and claims adjusters who are primarily responsible for the day-to-day process of selling and servicing flood insurance policies.

The NFIP Pays Expenses and Claims with Premiums to the Extent Possible, but Its Financial Structure Is Not Designed to Be Actuarially Sound

To the extent possible, the NFIP is designed to pay operating expenses and flood insurance claims with premiums collected on flood insurance policies rather than with tax dollars. However, as we have reported, the program, by design, is not actuarially sound because Congress authorized subsidized insurance rates to be made available for policies covering some properties to encourage communities to join the program. As a result, the program does not collect sufficient premium income to build reserves to meet the long-term future expected flood losses.[9] FEMA has statutory authority to borrow funds from the Treasury to keep the NFIP solvent.[10]

Until the 2004 hurricane season, FEMA had been generally successful in keeping the NFIP on sound financial footing, exercising its borrowing authority three times in the last decade when losses exceeded available

[8] GAO, *Flood Map Modernization: Program Strategy Shows Promise, but Challenges Remain*, GAO-04-417 (Washington, D.C.: Mar. 31, 2004).

[9] GAO, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, GAO-01-992T (Washington, D.C.: July 2001).

[10] See 42 U.S.C. 4016.

fund balances. In each instance, FEMA repaid the funds with interest. According to FEMA officials, as of August 31, 2005, FEMA had outstanding borrowing of $225 million with cash on hand totaling $289 million. FEMA had substantially repaid the borrowing it had undertaken to pay losses incurred for the 2004 hurricane season that, until Hurricane Katrina struck, was the worst hurricane season on record for the NFIP. FEMA's current debt with the Treasury is almost entirely for payment of claims from Hurricanes Katrina and Rita and other flood events that occurred in 2005.

Premium Subsidies and Repetitive-Loss Properties Affect NFIP's Actuarial Soundness

As the destruction caused by horrendous 2004 and 2005 hurricanes are a driving force for improving the NFIP today, devastating natural disasters in the 1960s were a primary reason for the national interest in creating a federal flood insurance program. In 1963 and 1964, Hurricane Betsy and other hurricanes caused extensive damage in the South, and, in 1965, heavy flooding occurred on the upper Mississippi River. In studying insurance alternatives to disaster assistance for people suffering property losses in floods, a flood insurance feasibility study found that premium rates in certain flood-prone areas could be extremely high. As a result, the National Flood Insurance Act of 1968, which created the NFIP, mandated that existing buildings in flood-risk areas would receive subsidies on premiums because these structures were built before the flood risk was known and identified on flood insurance rate maps.[11] Owners of structures built in flood-prone areas on or after the effective date of the first flood insurance rate maps in their areas or after December 31, 1974, would have to pay full actuarial rates.[12] Because many repetitive loss properties were built before either December 31, 1974, or the effective date of the first flood insurance rate maps in their areas, they were eligible for subsidized premium rates under provisions of the National Flood Insurance Act of 1968.

The provision of subsidized premiums encouraged communities to participate in the NFIP by adopting and agreeing to enforce state and community floodplain management regulations to reduce future flood damage. In April 2005, FEMA estimated that floodplain management regulations enforced by communities participating in the NFIP have prevented over $1.1 billion annually in flood damage.

[11] 42 U.S.C. 4014(a)(2), 4015(a), (b).

[12] 42 U.S.C. 4014(a)(1), 4015(c).

However, the policy subsidies reduce premium income and add risk to the NFIP. In January 2006, FEMA estimated an annual shortfall in premium income of $750 million because of policy subsidies. FEMA estimated that phasing out subsidized rates for non-primary residences and nonresidential properties alone would affect about 400,000 properties currently insured by the NFIP. Some have questioned whether providing flood insurance for second homes in high risk areas—such as barrier islands—encourages development in areas at high risk of flooding.

In addition, some of the properties that had received the initial rate subsidy are subject to repetitive flood losses, placing added financial strain on the NFIP. In reauthorizing the NFIP in 2004, Congress noted that "repetitive-loss properties"—those that had resulted in two or more flood insurance claims payments of $1,000 or more over 10 years—constituted a significant drain on the resources of the NFIP. [13] These repetitive loss properties are problematic not only because of their vulnerability to flooding but also because of the costs of repeatedly repairing flood damages. While these properties make up only about 1 percent of the properties insured under the NFIP, they account for 25 to 30 percent of all claims losses. At the time of our March 2004 report on repetitive loss properties, there were about 49,000 repetitive loss properties, representing about $4.6 billion in claims payments from 1978 until March 2004. As of March 2004, nearly half of all nationwide repetitive loss property insurance payments had been made in Louisiana, Texas, and Florida. According to a recent Congressional Research Service report, as of December 31, 2004, FEMA had identified 11,706 "severe repetitive loss" properties, defined as those with four or more claims or two or three losses that exceeded the insured value of the property.[14] Of these 11,706 properties almost half (49 percent) were in three states—3,208 (27 percent) in Louisiana, 1,573 (13 percent) in Texas, and 1,034 (9 percent) in New Jersey. A significant number of repetitive loss properties were affected by Hurricanes Katrina and Rita. According to NFIP statistical data through November 30, 2005, 4,835 repetitive loss properties, including 3,183 in Louisiana, had substantial damage from Hurricane Katrina.[15] Two hundred and forty-three

[13] Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, section 2(3),(4), (5), 118 Stat. 712, 713 (2004).

[14] Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem*, RL32972 (Washington, D.C.: June 30, 2005).

[15] The term "substantial damage" means the cost of repairing the damaged building exceeds 50 percent of its market value (or a lower trigger if adopted locally).

repetitive loss properties had substantial damage from Hurricane Rita. Of these properties, 213 were located in Louisiana and 30 were located in Texas.

For over a decade, FEMA has pursued a variety of strategies to reduce the number of repetitive loss properties in the NFIP inventory. In a 2004 testimony, we noted that congressional proposals have been made to phase out coverage or begin charging full and actuarially based rates for repetitive loss property owners who refuse to accept FEMA's offer to purchase or mitigate the effect of floods on these buildings.[16] The 2004 Flood Insurance Reform Act created a 5-year pilot program to deal with repetitive-loss properties in the NFIP. In particular, the act authorized FEMA to provide financial assistance to participating states and communities to carry out mitigation activities or to purchase "severe repetitive loss properties."[17] During the pilot program, policyholders who refuse a mitigation or purchase offer that meets program requirements will be required to pay increased premium rates. Specifically, the premium rates for these policyholders would increase by 150 percent following their refusal and another 150% following future claims of more than $1,500.[18] However, the rates charged cannot exceed the applicable actuarial rate.

Because of the financial drain that repetitive loss properties have posed for the program, it will be important in future studies of the NFIP to continue to analyze data on progress being made to reduce the inventory of subsidized NFIP properties, particularly those with repetitive losses; how the reduction of this inventory contributes to the financial stability of the program; and whether additional FEMA regulatory steps or congressional actions could contribute to the financial solvency of the NFIP, while meeting commitments made by the authorizing legislation.

[16]GAO, *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, GAO-04-401T (Washington, D.C.: Mar. 25, 2004).

[17]Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, section 102, 118 Stat. 712, 714-721 (2004). The act defines a "severe repetitive loss property" to mean single-family properties that have received at least $20,000 in flood insurance payments based on four or more claims of at least $5,000 each. The act requires FEMA to define in future regulation which multi-family properties constitute "severe repetitive loss properties."

[18]*Id.*, 118 Stat. 712, 717-718 (2004).

Expansion of the NFIP Policyholder Base

Compliance with Mandatory Purchase Requirements Difficult to Determine

In 1973 and 1994, Congress enacted requirements for mandatory purchase of NFIP policies by some property owners in high-risk areas. From 1968 until the adoption of the Flood Disaster Protection Act of 1973, the purchase of flood insurance was voluntary. However, because voluntary participation in the NFIP was low and many flood victims did not have insurance to repair damages from floods in the early 1970s, the 1973 act required the mandatory purchase of flood insurance to cover some structures in special flood hazard areas of communities participating in the program. Homeowners with mortgages held by federally-regulated lenders on property in communities identified by FEMA to be in special flood hazard areas are required to purchase flood insurance on their dwellings for the amount of their outstanding mortgage balance, up to a maximum of $250,000 in coverage for single family homes. The owners of properties with no mortgages or properties with mortgages held by lenders who are not federally regulated were not, and still are not, required to buy flood insurance, even if the properties are in special flood hazard areas—the areas NFIP flood maps identify as having the highest risk of flooding.

FEMA determines flood risk and actuarial ratings on properties through flood insurance rate mapping and other considerations, including the elevation of the lowest floor of the building, the type of building, the number of floors, and whether or not the building has a basement, among other factors. FEMA flood maps designate areas for risk of flooding by zones. For example, areas subject to damage by waves and storm surge are in the zone with the highest expectation for flood loss.

Between 1973 and 1994, many policyholders continued to find it easy to drop policies, even if the policies were required by lenders. Federal agency lenders and regulators did not appear to strongly enforce the mandatory flood insurance purchase requirements.[19] According to a recent

[19]The federal entities for lending regulation are the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Farm Credit Administration.

Congressional Research Service study,[20] the Midwest flood of 1993 highlighted this problem and reinforced the idea that reforms were needed to compel lender compliance with the requirements of the 1973 Act. In response, Congress passed the National Flood Insurance Reform Act of 1994. Under the 1994 law, if the property owner failed to get the required coverage, federally-regulated lenders were required to purchase flood insurance on their behalf and then bill the property owners. Lenders became subject to civil monetary penalties for not enforcing the mandatory purchase requirement.

In June 2002, we reported that the extent to which lenders were enforcing the mandatory purchase requirement was unknown. Officials involved with the flood insurance program developed contrasting viewpoints about whether lenders were complying with the flood insurance purchase requirements primarily because the officials used differing types of data to reach their conclusions. Federal bank regulators and lenders based their belief that lenders were generally complying with the NFIP's purchase requirements on regulators' examinations and reviews conducted to monitor and verify lender compliance. In contrast, FEMA officials believed that many lenders frequently were not complying with the requirements, which was an opinion based largely on noncompliance estimates computed from data on mortgages, flood zones, and insurance policies; limited studies on compliance; and anecdotal evidence indicating that insurance was not always in place where required. Neither side, however, was able to substantiate its differing claims with statistically sound data that provide a nationwide perspective on lender compliance.[21]

Expansion of Mandatory Purchase Requirements Would Generate More Premiums, but Implementation Could Be Problematic

Under FEMA's current Mandatory Purchase of Flood Insurance Guidelines, properties in a 100-year flood plain with a statistical 1 in 100 chance of flooding in any given year or a 30 percent chance of flooding during the period of a 30-year mortgage are designated to be in special flood hazard areas. Within the boundaries of these areas, homeowners with mortgages from federal regulated lenders are required to purchase flood insurance for an amount equal to their outstanding mortgage balance, up to the maximum policy limit of $250,000 for a single-family home. To expand the NFIP policyholder base, there has been some

[20]Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem* (June 30, 2005).

[21]GAO, *Flood Insurance: Extent of Noncompliance with Purchase Requirements Is Unknown*, GAO-02-396 (Washington, D.C: June 21, 2002).

congressional interest in the feasibility of extending the current mandatory purchase requirement to properties in a 500-year flood plain, which statistically have a 1 in 500 chance of flooding in any given year.[22] FEMA has estimated that expanding NFIP mandatory purchase requirements to include structures in the 500-year flood plain would generate up to $700 million in additional premiums. The current annual premium for a structure in the 500-year flood plain is about $280. However, a FEMA official cautioned that the rate of compliance is an important component of any estimate of the amount of increase in NFIP premiums that would result from expanding mandatory purchase requirements.

It would be difficult to effectively assess the impacts, effectiveness, and feasibility of such a change in the structure of the NFIP. We share FEMA's concerns related to enforcing and assessing compliance. We also believe that it would be difficult to assess the impacts an expansion in the mandatory purchase requirements would have upon a range of stakeholders, including not only home and business owners, but lenders, mortgage servicers, builders, and local governments, among others.

We also recognize that it would be difficult and costly to determine the additional geographic area that would be encompassed in an expanded special flood hazard area. Current flood mapping focuses on the boundaries of the 100-year flood plain, and FEMA has not estimated the additional cost and time required to complete detailed, digitalized maps of areas outside of the current 100-year special flood hazard area.

FEMA Has a Marketing Campaign to Attract New Policyholders and Improve Rates of Renewal

In recent years, the number of NFIP policyholders did not grow substantially. FEMA officials reported a pattern in which at the start of each hurricane season, the number of polices in force was the same or less than the number of policies in previous years. During the hurricane season, the number of polices in force would increase slightly and then level off or decline again at the end of the season.

FEMA has efforts underway to increase NFIP participation by improving the quality of information that is available on the NFIP and flood risks and by marketing to retain policyholders currently in the program. In October 2003, FEMA let a contract for a new integrated marketing campaign called "FloodSmart." Marketing elements being used include direct mail, national

[22]National Flood Insurance Program Commitment to Policyholders and Reform Act of 2005, H.R. 4320, 109th Conress, section 3 (2005).

television commercials, print advertising, and websites designed for consumers and insurance agents. According to FEMA officials, in a little more than 2 years since the contract began, net policy growth was a little more than 7 percent and policy retention improved from 88 percent to 91 percent.

Accurate, Updated Flood Maps Are the Foundation of the NFIP

Accurate flood maps that identify the areas at greatest risk of flooding are the foundation of the NFIP. Flood maps must be periodically updated to assess and map changes in the boundaries of floodplains that result from community growth, development, erosion, and other factors that affect the boundaries of areas at risk of flooding. FEMA has embarked on a multi-year effort to update the nation's flood maps at a cost in excess of $1 billion. The maps are principally used by (1) the approximately 20,000 communities participating in the NFIP to adopt and enforce the program's minimum building standards for new construction within the maps' identified flood plains; (2) FEMA to develop accurate flood insurance policy rates based on flood risk; and (3) federal regulated mortgage lenders to identify those property owners who are statutorily required to purchase federal flood insurance.

FEMA expects that by producing more accurate and accessible digital flood maps, the NFIP and the nation will benefit in three ways. First, communities can use more accurate digital maps to reduce flood risk within floodplains by more effectively regulating development through zoning and building standards. Second, accurate digital maps available on the Internet will facilitate the identification of property owners who are statutorily required to obtain or who would be best served by obtaining flood insurance. Third, accurate and precise data will help national, state, and local officials to accurately locate infrastructure and transportation systems (e.g., power plants, sewage plants, railroads, bridges, and ports) to help mitigate and manage risk for multiple hazards, both natural and man-made.

Success in updating the nation's flood maps requires clear standards for map development; the coordinated efforts and shared resources of federal, state, and local governments; and the involvement of key stakeholders who will be expected to use the maps. In developing the new data system to update flood maps across the nation, FEMA's intent is to develop and incorporate flood risk data that are of a level of specificity and accuracy commensurate with communities' relative flood risks. Not every community may need the same level of specificity and detail in its new flood maps. However, it is important that FEMA establish standards for the appropriate data and level of analysis required to develop maps for all communities of a similar risk level. In its November 2004 Multi-Year Flood Hazard Identification Plan, FEMA discussed the varying types of data collection and analysis techniques the agency plans to use to develop flood hazard data in order to relate the level of study and level of risk for each of 3,146 counties.

FEMA has developed targets for resource contributions (in-kind as well as dollars) by its state and local partners in updating the nation's flood maps. At the same time, it has developed plans for reaching out to and including the input of communities and key stakeholders in the development of the new maps. These expanded outreach efforts reflect FEMA's understanding that it is dependent upon others to achieve the benefits of map modernization.

As I have discussed, it is important when considering any expansion of mandatory purchase requirements for NFIP policies to understand that implementation would require the development of additional detailed flood maps. According to a FEMA official, digital mapping of areas outside of special flood hazard areas is currently being considered on only a selective basis for reasons such as potential changes in risk level or population growth.

Monitoring and Oversight of NFIP Identifies Specific Problems, but Does Not Provide Comprehensive Information on Overall Program Performance

To meet its monitoring and oversight responsibilities, FEMA is to conduct periodic operational reviews of the 95 private insurance companies that participate in the NFIP. In addition, FEMA's program contractor is to check the accuracy of claims settlements by doing quality assurance reinspections of a sample of claims adjustments for every flood event. For operational reviews, FEMA examiners are to do a thorough review of the companies' NFIP underwriting and claims settlement processes and internal controls, including checking a sample of claims and underwriting files to determine, for example, whether a violation of policy has occurred, an incorrect payment has been made, and if files contain all required documentation. Separately, FEMA's program contractor is responsible for conducting quality assurance reinspections of a sample of claims adjustments for specific flood events in order to identify, for example, whether an insurer allowed an uncovered expense or missed a covered expense in the original adjustment.

According to FEMA, these monitoring and oversight mechanisms will be in place to assess the implementation of the NFIP after Hurricanes Katrina and Rita. In addition, FEMA plans to do additional oversight of claims for these storms that were handled using expedited procedures. To try to assist NFIP policyholders despite obstacles in communicating with claimants, reaching flooded properties, and locating records, FEMA allowed expedited claims processing procedures that were unique to these storms. In some circumstances, claims were settled without site visits by certified flood claims adjusters. For flooding caused by the failure of the levees in the New Orleans area, resulting in flooding from Lake Pontchartrain, FEMA allowed the use of flood depth data to identify structures that had been severely affected. If data on the depth and duration of the water in the building showed that it was likely that covered damage exceeded policy limits, claims could be settled without a site visit by a claims adjuster. Similarly, losses in other areas of Louisiana and Mississippi were handled without a site visit where structures were washed off their foundations by flood waters and square-foot measurements of the dwellings were known.

The operational reviews and follow-up visits to insurance companies that we analyzed during 2005 followed FEMA's internal control procedures for identifying and resolving specific problems that may occur in individual insurance companies' processes for selling and renewing NFIP policies and adjusting claims. According to information provided by FEMA, the number of operational reviews completed between 2000 and August 2005 were done at a pace that allows for a review of each participating insurance company at least once every 3 years, as FEMA procedures require. In addition, the processes FEMA had in place for operational reviews and quality assurance reinspections of claims adjustments met our internal control standard for monitoring federal programs.

However, the process FEMA used to select a sample of claims files for operational reviews and the process its program contractor used to select a sample of adjustments for reinspections were not randomly chosen or statistically representative of all claims. We found that the selection processes used were, instead, based upon judgmental criteria including, among other items, the size and location of loss and complexity of claims. As a result of limitations in the sampling processes, FEMA cannot project the results of these monitoring and oversight activities to determine the overall accuracy of claims settled for specific flood events or assess the overall performance of insurance companies and their adjusters in fulfilling their responsibilities for the NFIP—actions necessary for FEMA to meet our internal control standard that it have reasonable assurance that program objectives are being achieved and that its operations are effective and efficient.

To strengthen and improve FEMA's monitoring and oversight of the NFIP, we recommended that FEMA use a methodologically valid approach for sampling files selected for operational reviews and quality assurance claims reinspections. We also plan to follow up on the results of the monitoring and oversight efforts for claims processed using expedited processes in our review of the implementation of the NFIP after Hurricanes Katrina and Rita.

FEMA did not agree with our recommendation. It noted that its current sampling methodology of selecting a sample based on knowledge of the population to be sampled was more appropriate for identifying problems than the statistically random probability sample we recommended. Although FEMA's current nonprobability sampling strategy may provide an opportunity to focus on particular areas of risk, it does not provide management with the information needed to assess the overall performance of private insurance companies and adjusters participating in the program—information that FEMA needs to have reasonable assurance that program objectives are being achieved.

FEMA Has Not Fully Implemented NFIP Program Changes Mandated by the Flood Insurance Reform Act of 2004

As of January 2006, FEMA had not yet fully implemented provisions of the Flood Insurance Reform Act of 2004. Among other things, the act requires FEMA to provide policyholders a flood insurance claims handbook; to establish a regulatory appeals process for claimants; and to establish minimum education and training requirements for insurance agents who sell NFIP policies.[23] The 6-month statutory deadline for implementing these changes was December 30, 2004.

In September 2005, FEMA posted a flood insurance claims handbook on its Web site. The handbook contains information on anticipating, filing and appealing a claim through an informal appeals process, which FEMA intends to use pending the establishment of a regulatory appeals process. However, because the handbook does not contain information regarding the appeals process that FEMA is statutorily required to establish through regulation, it does not yet meet statutory requirements.

With respect to this appeals process, FEMA has not stated how long rulemaking might take to establish the process by regulation, or how the process might work, such as filing requirements, time frames for considering appeals, and the composition of an appeals board. In January 2006, the acting director of FEMA's Mitigation Division said that FEMA

[23] Flood Insurance Reform Act of 2004, Pub. L. No. 108-264, sections 204, 205, and 207.

had submitted a draft rule to DHS. However, milestones for future actions were not established. Claimants who wish to appeal decisions made on their claims for damage from Hurricanes Katrina and Rita can follow a process described by FEMA as an "informal" appeals process. As outlined in the Flood Insurance Claims Handbook, to appeal, policyholders are to submit statements of their concerns and supporting documentation to the director of claims in FEMA's Mitigation Division, Risk Insurance Branch.

With respect to minimum training and education requirements for insurance agents who sell NFIP policies, FEMA published a Federal Register notice on September 1, 2005, which included an outline of training course materials. In the notice, FEMA stated that, rather than establish separate and perhaps duplicative requirements from those that may already be in place in the states, it had chosen to work with the states to implement the NFIP requirements through already established state licensing schemes for insurance agents. The notice did not specify how or when states were to begin implementing the NFIP training and education requirements. Thus, it is too early to tell the extent to which insurance agents will meet FEMA's minimum standards. FEMA officials said that, because changes to the program could have broad reaching and significant effects on policyholders and private-sector stakeholders upon whom FEMA relies to implement the program, the agency is taking a measured approach to addressing the changes mandated by Congress. Nonetheless, without plans with milestones for completing its efforts to address the provisions of the act, FEMA cannot hold responsible officials accountable or ensure that statutorily required improvements are in place to assist victims of future flood events.

We recommended that FEMA develop documented plans with milestones for implementing requirements of the Flood Insurance Reform Act of 2004 to provide policyholders a flood insurance claims handbook that meets statutory requirements, to establish a regulatory appeals process, and to ensure that flood insurance agents meet minimum NFIP education and training requirements. We will continue to monitor progress being made.

FEMA disagreed with our recommendation and characterization of the extent to which FEMA has met provisions of the Flood Insurance Reform Act of 2004. We believe that our description of those efforts and our recommendations with regard to implementing the act's provisions are valid. For example, although FEMA commented that it was offering claimants an informal appeals process in its flood insurance claims handbook, it must establish regulations for this process, and those are not yet complete.

Concluding Observations

The most immediate challenge for the NFIP is processing the flood insurance claims resulting from Hurricanes Katrina and Rita. Progress is being made in that area. In December 2005, according to FEMA, more than 70 percent of Hurricane Katrina claims had been paid, totaling more than $11 billion, some of them using expedited procedures to assist policyholders who were displaced from their homes.

In the longer term, Congress and the NFIP face a complex challenge in assessing potential changes to the program that would improve its financial stability, increase participation in the program by property owners in areas at risk of flooding, reduce the number of repetitive loss properties in the program, and maintain current and accurate flood plain maps. These issues are complex, interrelated, and are likely to involve trade-offs. For example, increasing premiums to better reflect risk may reduce voluntary participation in the program or encourage those who are required to purchase flood insurance to limit their coverage to the minimum required amount (i.e., the amount of their outstanding mortgage balance). This in turn can increase taxpayer exposure for disaster assistance resulting from flooding. There is no "silver bullet" for improving the current structure and operations of the NFIP. It will require sound data and analysis and the cooperation and participation of many stakeholders.

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be pleased to respond to any questions you and the Committee Members may have.

GAO Contact and Staff Acknowledgments

Contact point for our Office of Congressional Relations and Public Affairs may be found on the last page of this statement. For further information about this testimony, please contact Norman Rabkin at (202) 512-8777 or rabkinn@gao.gov, or William O. Jenkins Jr. at (202) 512-8757 or jenkinswo@gao.gov. This statement was prepared under the direction of Christopher Keisling. Key contributors were John Bagnulo, Christine Davis, and Deborah Knorr.

PREPARED STATEMENT OF DAVID I. MAURSTAD

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U.S. DEPARTMENT OF HOMELAND SECURITY

JANUARY 25, 2006

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I am David Maurstad, Acting Mitigation Division Director and Federal Insurance Administrator for the Federal Emergency Management Agency (FEMA) within the U.S. 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), particularly after the devastating effects of last year's hurricane season.

As I did during my October testimony before this Committee, I would like to provide a context for what the NFIP is facing as a result of Hurricanes Katrina, Rita, and Wilma. 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. Since the NFIP's inception in 1968 through 2004, a total of $15 billion has been paid out to cover more than 1.3 million losses. Simultaneously, the NFIP's floodplain management efforts are now reducing the potential losses from floods by an average of $1.1 billion a year.

Since the June 30, 2004 signing of the Flood Insurance Reform Act (FIRA04), this country has experienced back-to-back catastrophic hurricane seasons. The 2004 hurricane season resulted in over 75,000 claims totaling close to $2 billion dollars paid out in NFIP coverage. The 2005 hurricane season has resulted in payments totaling over $13.5 billion to date—nearly matching the total amount paid out over the NFIP's 37-year existence.

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 Department. Our authority to borrow from the Treasury is an essential part of the NFIP's financing design for heavy loss years. This authority enables the program to borrow limited amounts from the Treasury on occasions when income is not sufficient to cover losses and related costs. These loans have been repaid, with interest, from policyholder premiums and related fees, and at no cost to the Nation's taxpayers. Thus, the program has successfully provided economic resources to help individuals and businesses recover from flood disasters. Without this program, the demand on the Disaster Relief Fund and other Federal relief programs would be extreme.

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.

Yet, the NFIP continues to effectively operate as intended. In the nearly 5 months since Hurricanes Katrina, Rita, and Wilma struck the Gulf Coast, the NFIP has resolved over 70 percent of the 239,000 claims filed from these events. This volume far exceeds the highest number of claims filed from any single event in the NFIP's history, and is more than triple the total number of claims filed in 2004. Our industry partners, the Write-Your-Own (WYO) insurance companies, claims adjusters, and agents, have more than fulfilled their responsibility to help policyholders begin to rebuild their lives.

We are fulfilling the promises we made to our policyholders and NFIP communities, and the NFIP is effectively serving our policyholders in the wake of the worst natural disaster this Nation has ever experienced. FEMA is proud of the NFIP's ability to provide good customer service to our flood insurance policyholders—people who had the foresight to do the right thing and protect their homes and businesses from the perils of flooding.

In October, I informed you that we expect the total NFIP payout (claims and associated expenses) for these events to be over $23 billion—more than all of the claims paid in the entire history of the NFIP. We have reexamined these projections based on claims to date, and we still believe that these estimates are valid. As you will note in Exhibit 1, claims payments will exceed $22 billion for Hurricane Katrina alone.

Today, my testimony will focus on the NFIP's financial and program status and options for strengthening the program.

NFIP Financial and Program Status

The NFIP currently insures in excess of $800 billion in assets. This covers more than 4.8 million policies for homes, businesses, and other nonresidential property owners. Each year the NFIP collects approximately $2 billion in premiums and fees. As previously stated, $15 billion has been paid out since the NFIP's inception through 2004 to cover more than 1.3 million losses. 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 unavailable. Yet these property owners endured as much of an individual loss as those in larger events. In this regard, studies have indicated that insurance is the most efficient and equitable method of providing disaster assistance.[1]

The NFIP provides insurance at actuarial (risk-based) rates for newer construction, with approximately 76 percent of policyholders paying actuarial rates. For structures built prior to the mapping and implementation of NFIP floodplain management requirements (approximately 24 percent of the policies), heavily subsidized rates are charged on the first $35,000 of insured value because flood risks were not fully known to the property owner when these structures were built. For these structures full risk-based rates are charged for limits beyond the first $35,000 of coverage. On average, these policyholders are paying only 40 percent of a full risk-based premium.

As mentioned earlier, we anticipate that total borrowing for the 2005 hurricanes will exceed $23 billion. Annual interest on such borrowing will exceed $1 billion.

Congress increased the NFIP's borrowing authority to $18.5 billion in November due to Hurricanes Katrina, Rita, and Wilma. This additional borrowing authority has been a critical element of the NFIP's ability to effectively serve our policyholders, allowing FEMA to resolve three-quarters of the Katrina, Rita, and Wilma claims received to date.

Most importantly, as shown in Exhibit 2, NFIP projections indicate that flood insurance claims payments will reach the new $18.5 billion borrowing limit by early to mid-February 2006. The program will require an additional $5.6 billion in borrowing authority to cover claims and expenses through fiscal year 2006. Additionally, language in the 2006 DHS Appropriations Act limits interest payments to Treasury to $30 million, which is not sufficient for the program to fulfill its interest obligations. In order for the program to meet its obligations to the Treasury, the interest cap needs to be waived or raised to at least $670 million.

The 2004 Flood Insurance Reform Act was a catalyst for improvements to the NFIP. We began implementing these changes during the 2004 hurricane season and improved our delivery of them during the 2005 hurricane season. Our approach included expanded communication to increase awareness and effective processing of claims.

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 are being distributed to all policyholders at the time of initial purchase, policy renewal, and at the time a claim is filed. In addition, these materials have been distributed in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers—as well as in Town Meetings—since September 1, 2005. I have personally handed these materials to State Insurance Commissioners in Alabama, Mississippi, and Louisiana, and we have distributed an informational CD containing these documents and other ready-to-print materials to field offices, State and local government offices, and the media.

Also, recognizing that a significant number of policyholders were displaced, FEMA has implemented several systems to reach policyholders early in the claims process. These systems have been 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. It has

[1] See GAO Report, PAD–80–39.

enabled 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.

We have also aggressively worked with the insurance industry to implement the minimum training requirements for all flood insurance agents who sell flood insurance. I have met with and given presentations to the National Association of Insurance Commissioners and the National Conference of Insurance Legislators on several occasions. We have also conducted three webcasts covering the NFIP and program improvements for State insurance commissioners and their staff. The training requirements were published in the September 1, 2005 *Federal Register,* and we are working with the States as well as the insurance industry and related associations to inform insurance companies and agents of these requirements.

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.

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.

Utilizing state-of-the-art aerial imagery, up-to-date water-depth data, and information from extensive underwriting files, the Write-Your-Own (WYO) insurance companies have been able to rapidly identify insured properties that have been washed off their foundations, have had standing water in them for an extended period, or have only pilings or concrete slabs remaining. In addition, FEMA waived proof of loss requirements and has fast-tracked claims up to the maximum insured value.

These streamlining methods have substantially reduced our normal adjustment times from what one would normally see under such extreme circumstances. Further, this process provided a mechanism for rapidly resolving claims within 60 days of the event. By November 1, over 30,000 claims had been handled through our expedited claims process, and over $1.8 billion were made available to policyholders. From the beginning, FEMA general adjusters and claims staff have been in the field reinspecting sample sets of claims in order to ensure the integrity of the process.

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. Citizens are anxious to begin recovering, and updated flood hazard information is being provided to help guide reconstruction. At the request of Mississippi officials, FEMA provided the State with Advisory Base Flood Elevations to help rebuilding efforts for the State's three most heavily affected counties. In Louisiana, Advisory Base Flood Elevations were provided for 11 of the 15 parishes affected. As more information becomes available, FEMA will release it to communities. This phased data development effort will ultimately result in revised Digital Flood Insurance Rate Maps.

FEMA anticipates that preliminary Digital Flood Insurance Rate Maps (DFIRM's) will be issued for Mississippi by August 2006. Preliminary DFIRM's will be provided to the parishes and communities in Louisiana beginning in the fall of 2006. By early 2007 all impacted Louisiana parishes are scheduled to receive preliminary DFIRM's.

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. The Midwest Flood of 1993 strengthened lender compliance requirements by introducing penalties for noncompliance with mandatory purchase provisions of the statute with the National Flood Insurance Reform Act of 1994. It is entirely appropriate, because of the 2004 and 2005 hurricane seasons, to once again examine ways to strengthen the NFIP.

In my October testimony before this Committee, I outlined the following mitigation and insurance principles:

- Protect the NFIP's integrity by covering existing commitments and liabilities;
- Phase out subsidized 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 subsidies 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 responsibilities.
- Reduce the period of time a new policyholder must wait before an NFIP policy takes effect from 30 days to 15 days.
- Direct FEMA to study the feasibility and implications of expanding the standard for mandatory purchase requirement to include properties in the 0.2 percent chance per year floodplain (500-year flood plain) and properties in areas of residual risk (structures protected by levees, dams, and other manmade structures).
- 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.
- Direct FEMA to study the feasibility and implications of offering Additional Living Expense coverage and Business Interruption coverage.

A strengthened NFIP, combined with the implementation of a sound mitigation strategy, will provide even more support to NFIP policyholders and will continue to help communities reduce their vulnerability to flooding events in a cost-effective manner. According to a Congressionally mandated study recently released by the National Institute of Building Sciences, each dollar spent on disaster mitigation saves an average of $4. Mitigation, combined with a strengthened NFIP, results in significant benefits to society as a whole—to individuals, States, and communities. These benefits represent reduced economic losses, and significant savings to the Federal treasury.

Conclusion

The 2005 hurricane season has presented the NFIP with numerous challenges on a variety of fronts. However, it is important to remember that these challenges are not the result of a broken program; rather, they are the result of the most catastrophic back-to-back hurricane seasons this Nation has ever experienced. The program has, for more than 37 years, through sound floodplain management, mitigation, and insurance, helped people recover from the devastation of floods while saving the Nation more than $1 billion annually.

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.

In order to continue to meet existing claims, the program will need an additional $5.6 billion in borrowing authority to cover claims and expenses through fiscal year 2006. Additionally, the limitation on interest payments to the Treasury needs to be waived or raised to at least $670 million for the program to meet its obligations to the Treasury.

I look forward to continuing to work with the Committee, our NFIP WYO companies, agent groups, and other partners to not only complete implementation of the FIRA04, but also implement future changes to the NFIP.

I would be pleased to answer any questions Committee Members may have.

NATIONAL FLOOD INSURANCE PROGRAM
Estimate of Ultimate Paid Losses from Hurricane Katrina

	Total PIF	Total Coverage	Assumed Frequency	Estimated # Claims	Assumed Severity	Estimated $ Paid
Counties most impacted by Katrina						
Alabama						
Baldwin County	20,423	3,185,594,800	30.0%	6,127	$ 60,000	$ 367,620,000
Mobile County	6,877	1,082,665,900	30.0%	2,063	$ 60,000	$ 123,780,000
Mississippi						
Hancock County	5,462	739,082,600	85.0%	4,643	$ 120,000	$ 557,160,000
Harrison County	10,218	1,569,645,100	85.0%	8,685	$ 135,000	$ 1,172,475,000
Jackson County	5,913	890,349,100	85.0%	5,026	$ 135,000	$ 678,510,000
Lousiana						
Jefferson Parish	110,258	17,231,143,900	45.0%	49,616	$ 75,000	$ 3,721,200,000
Lafayette Parish	9,180	1,289,897,500	37.5%	3,443	$ 75,000	$ 258,225,000
Lafourche Parish	9,334	1,070,954,700	37.5%	3,500	$ 75,000	$ 262,500,000
Orleans Parish	85,771	12,699,150,500	80.0%	68,617	$ 120,000	$ 8,234,040,000
Plaquemines Parish	5,099	790,362,800	70.0%	3,569	$ 120,000	$ 428,280,000
St. Bernard Parish	15,823	2,185,079,000	70.0%	11,076	$ 120,000	$ 1,329,120,000
St. Tammany Parish	37,286	7,191,114,100	37.5%	13,982	$ 75,000	$ 1,048,650,000
Florida						
South FL Counties	910,933	159,150,128,000	1.0%	9,109	$ 22,500	$ 204,952,500
Escambia County	14,681	2,750,764,500	7.5%	1,101	$ 50,000	$ 55,050,000
Okaloosa County	18,085	3,092,233,600	2.5%	452	$ 35,000	$ 15,820,000
Santa Rosa County	8,183	1,930,472,900	5.0%	409	$ 40,000	$ 16,360,000
Counties with Low to Moderate Flooding						
	114,822	16,722,385,800	10.0%	11,482	$ 20,000	$ 229,640,000
Katrina - Building and Contents Losses				202,900	$ 92,180	$ 18,703,382,500
Katrina - Provision for ICC[1] Claims						$ 1,745,775,222
Provision for Loss Adjustment Expenses						$ 1,595,034,302
TOTAL Liability for Losses and Loss Adjustment Expenses						**$ 22,044,192,024**

[1] increased Cost of Compliance coverage

EXHIBIT 1

Projection of the Federal Cash Flow from NFIP Claims Payments for Hurricanes Katrina and Rita

	Dollars Paid and Presented for LOC Drawdowns by the WYO Companies for Hurricanes Katrina, Rita and Wilma			
Month End	% of Ultimate Dollars Paid ($M)	Total Paid & Presented for LOC Draws ($M)	Interest on Borrowing ($M)	**Estimated Borrowing Authority ($M)**
Aug-05	0.0%	$0		**($36)**
Sep-05	0.4%	$90	$2	**($128)**
Oct-05	3.9%	$925		**($963)**
Nov-05	35.5%	$8,396		**($8,435)**
12/01 - 12/02	38.3%	$9,079		**($9,117)**
12/05 - 12/09	47.9%	$11,342		**($11,380)**
12/12 - 12/16	50.5%	$11,955		**($11,994)**
12/19 - 12/23	53.7%	$12,714		**($12,753)**
12/26 - 12/31	57.4%	$13,587		**($13,626)**
01/02 - 01/06	60.9%	$14,408		**($14,446)**
01/09 - 01/13	64.3%	$15,229		**($15,267)**
01/16 - 01/20	67.8%	$16,053		**($16,091)**
01/23 - 01/27	71.1%	$16,827		**($16,865)**
01/30 - 01/31	73.8%	$17,469		**($17,508)**
02/01 - 02/03	75.5%	$17,883		**($17,921)**
02/06 - 02/10	77.2%	$18,267		**($18,306)**
02/13 - 02/17	78.6%	$18,597		**($18,635)**
02/20 - 02/24	79.9%	$18,926		**($18,964)**
02/27 - 02/28	81.2%	$19,226		**($19,264)**
Mar-06	82.1%	$19,435	$160	**($19,633)**
Apr-06	85.1%	$20,154		**($20,352)**
May-06	86.9%	$20,577		**($20,775)**
Jun-06	87.8%	$20,791		**($20,989)**
Jul-06	88.8%	$21,032		**($21,230)**
Aug-06	89.7%	$21,231		**($21,430)**
Sep-06	90.5%	$21,431	$511	**($22,141)**
	0			
Mar-07	96.2%	$22,768	$537	**($24,015)**
Sep-07	100.0%	$23,675	$589	**($25,510)**

NOTES:

- Dollars shown through January 13 are actual.
  Dollars shown for January 16 and forward are estimates.
- In addition to paying for Katrina, Rita and Wilma, the Fund will have premium income and will pay for flood losses from other events. The net effects of this other income and expenses on this exhibit are minor compared to these two hurricanes.
- The bulk of ICC claims payments will be made in FY 2007.

DRAFT: *Not for Public Release*

EXHIBIT 2

PREPARED STATEMENT OF DONALD B. MARRON

ACTING DIRECTOR, CONGRESSIONAL BUDGET OFFICE

JANUARY 25, 2006

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for offering the Congressional Budget Office (CBO) the opportunity to discuss issues related to the National Flood Insurance Program (NFIP), administered by the Federal Emergency Management Agency (FEMA). Established in 1968, the NFIP now includes over 20,000 communities that adhere to certain minimum standards for floodplain management. Within those participating communities, nearly 4.7 million policyholders pay more than $2.0 billion in premiums each year to receive over $800 billion in coverage.

By law, some policyholders—primarily those whose properties were built before their local community joined the program—receive coverage at rates that are explicitly subsidized. Lawmakers built those subsidies into the program partly on the grounds that actuarial (full-risk) premiums for many existing structures would be unattractively high. The subsidies have both benefits and costs. The immediate benefits to current property owners encourage communities to participate in the program, thereby reducing future flood losses through improved floodplain management and tighter building standards. Moreover, charging flood insurance premiums, even if they are subsidized, may encourage policyholders to take at least some notice of the risks to their properties. However, subsidized premiums provide less incentive than full-risk premiums would for policyholders to reduce their flood risks—and, of course, they impose costs on taxpayers.

In light of the devastation caused by last fall's hurricanes in the Gulf Coast, resulting in claims for flood damage estimated to exceed $20 billion, you asked CBO to address the size of the program's actuarial imbalance, the likely effects of reducing or eliminating the subsidies, and Congressional options for reforming the program's treatment in the budget. My testimony will make the following points:

- Almost 1.2 million policyholders, roughly one-quarter of the total, pay subsidized premiums. As a result, the program as a whole is not actuarially sound under current law. Historically, it has collected enough in premiums to pay for the losses experienced in a "usual" or "typical" year, which is why the actuarial imbalance was not more apparent prior to 2005, but it has not built up sufficient reserves to pay (or repay the borrowing) for the losses in a catastrophic year. On the basis of information from FEMA, CBO estimates that the program collects about 60 percent of the premiums needed for actuarial balance, leaving a cost to taxpayers estimated at about $1.3 billion per year.
- According to the available evidence, eliminating the subsidies would lead relatively few policyholders affected by the increases to drop all coverage but would induce many to cut it enough to keep their premiums roughly unchanged. The total premiums collected would also remain roughly constant. Those findings should be interpreted cautiously, though, because the available evidence is limited and some of the premiums that would be charged under actuarially fair rates would be well outside the range of past experience.
- Regardless of the responses of policyholders, ending the subsidies entirely would eliminate the NFIP's actuarial imbalance, so the expected annual savings to the program would be $1.3 billion. Smaller reductions in the subsidies would yield smaller savings. The net savings to the Federal Government would be smaller if, in response to future floods, expenditures for disaster assistance to uninsured property owners and renters increased.
- Annual spending for the NFIP is inherently unpredictable, so even if the Congress amended the program to charge actuarially sound rates on all of its policies, the program would still require a backup source of funding, such as its borrowing authority. The difference would be that substantial reserves would build up in non-catastrophic years.
- The budget presents the NFIP's financial results and those of most other budget accounts on a cash basis. Adopting an approach similar to that used for loans and loan guarantees, which recognizes the long-run costs of the program by recording an actuarial estimate of the annual Federal liability, would better identify the Government's exposure to flood risk but would obscure estimates of the cash deficit. The choice of one budgetary treatment over another should be based on which presentation will better inform the policy choices faced by the Congress.

Background

Under the National Flood Insurance Program, currently authorized to sell annual policies through 2008, property owners can obtain coverage for damages to structures and contents of up to $350,000 for residential properties and $1 million for commercial properties. Many NFIP policies are purchased under a Federal statutory requirement that property owners maintain insurance up to the outstanding balance of their mortgage (or the applicable coverage limit, whichever is less) if their mortgage is federally insured or from a federally regulated lender and the property is located within a 100-year floodplain (an area that has at least a 1 percent chance of flooding in any given year). However, how well that requirement is enforced is uncertain. Most policies are sold and serviced on behalf of FEMA by private insurance companies, which retain a portion of the annual premiums to compensate them for those activities.

The NFIP reviews its insurance rates annually and has the authority to raise them by an average of not more than 10 percent a year for each risk category of property. Since 2001, the program has increased rates between 2 percent to 3 percent annually, on average.

The NFIP has the authority to charge premiums (within parameters set by its authorizing statute) and to spend income from those premiums to cover claims and underwriting expenses. Thus, flood insurance is classified in the budget as a mandatory, or direct spending, program. As a mandatory program, the NFIP does not receive regular appropriations for its activities from the general fund. However, annual appropriation acts for the Department of Homeland Security generally authorize spending for salaries and expenses related to flood insurance operations and flood mitigation, to be financed by a per-policy fee that depends on the type of insured property and that is considered separate from the premiums.

FEMA also has the authority to borrow additional amounts from the U.S. Treasury if the income from premiums falls short of expenses. The program is required to repay borrowed funds, with interest, from surplus premiums collected in years when claims for damages caused by floods are small. Before 2005, FEMA used its borrowing authority primarily as a means of financing claims within a fiscal year, and the agency generally managed to repay borrowed funds within a relatively short time. FEMA's borrowing authority was limited to $1.5 billion before Hurricane Katrina, but the Congress subsequently raised that limit twice last fall, bringing it to $18.5 billion. It is highly unlikely that the program will be able to repay that amount of borrowing out of its income from premiums and fees.

In some years, NFIP premiums and fees have exceeded payments for claims and administrative expenses (resulting in net negative outlays); in other years, total payments have exceeded total collections (resulting in net positive outlays). Over the past 20 years (through fiscal year 2005), the program had net negative outlays in 11 years and net positive outlays in 9 (see Figure 1). Over that 20-year period, cumulative net outlays of the program, measured in nominal (current) dollars, totaled only about $300 million. In sharp contrast, net outlays for fiscal year 2006 are likely to top $20 billion—if additional borrowing authority is enacted to allow the program to spend more than its current limit of $18.5 billion.

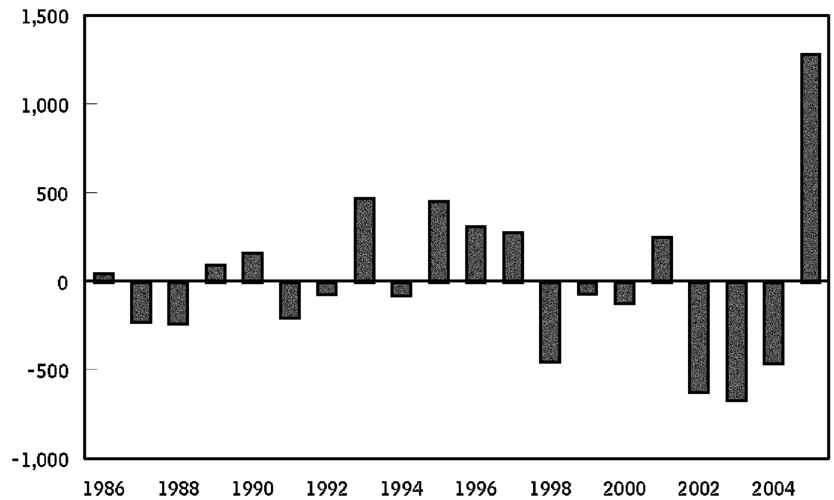
The Actuarial Imbalance in the NFIP

The available estimates of the current subsidies in the flood insurance program are based on FEMA's estimates of actuarially sound premiums. Those estimates could be too low—if, for example, the probabilities of very rare, catastrophic floods or levee failure are greater than FEMA assumes—or too high. CBO has no basis for concluding that the actuarial rates err in either direction, and the analysis underlying this testimony assumes that FEMA's estimates are correct.

Figure 1.

Net Outlays by the National Flood Insurance Fund, Fiscal Years 1986 to 2005

(Millions of nominal dollars)



Source: Congressional Budget Office based on *Budget of the United States Government, Appendix* (various years); and *Monthly Treasury Statement of Receipts and Outlays of the U.S. Government for Fiscal Year 2005 Through September 30, 2005.*

Roughly 1.2 million flood insurance policyholders, about one-quarter of the total, pay rates that are explicitly subsidized—that is, below the level that FEMA estimates would be required for the program to break even in the long-run. Those subsidies are built into the program by statute—or, in the case of one small group of properties, by an agreement 20 years ago with the Congressional oversight committees.[1]

By far, the largest group of explicitly subsidized policies is those covering "pre-FIRM" structures—meaning structures built before a community's flood insurance rate map (FIRM) was completed (or before 1975, whichever is later). FEMA estimates that pre-FIRM properties accounted for about 24 percent of all policies in 2005. The basic rationale for those subsidies is twofold: That the detailed information about risks that the flood maps provide was not available when those structures were built and that premiums incorporating their full risks would not encourage the desired levels of participation by individuals and communities. FEMA also charges subsidized rates on three smaller groups of properties, together representing about 2 percent of the policies in 2005.[2]

The explicit subsidies received by those policyholders apply only to a first tier of coverage. For example, subsidies apply to the first $35,000 of coverage for a one- to four-family dwelling and the first $100,000 for nonresidential and larger residential properties. Additional coverage above those limits is purchased at FEMA's

[1] Information on the subsidies is drawn largely from Thomas L. Hayes and Shama S. Sabade, *Actuarial Rate Review* (Federal Emergency Management Agency, November 30, 2004).

[2] Those three smaller groups include properties that will be protected against a 100-year flood (more precisely, against a flood whose probability of occurring in a given year is at least 1 percent, or 1 in 100) upon completion of a structural project that is already half finished; properties in areas served by structural measures that have been decertified as no longer protecting against such a flood if a schedule meeting certain criteria exists for restoring that level of protection; and properties subject to coastal flooding that were built between 1975 and 1981, the year when FEMA incorporated new information about wave heights and strengthened the building standards for new construction in such areas.

estimated actuarial rates. Since 1988, FEMA has set the subsidized rates with an eye to collecting premiums at least sufficient to cover payouts in the "historical average loss year"—that is, average losses observed since 1978. Since the program had never suffered a truly catastrophic loss until last year, that target was clearly below the level required to achieve actuarial balance.

FEMA estimates that the average premium paid on a pre-FIRM structure—taking into account coverage purchased in both the subsidized and actuarial tiers—is about 40 percent of the actuarial, or full-risk, rate. Nonetheless, the subsidized premiums are higher than the unsubsidized premiums, on average, reflecting the fact that properties built before communities joined the NFIP and implemented tighter land-use policies and building standards are typically at much higher risk of flooding. According to FEMA's estimates, the annual premium on the average unsubsidized policy was $340 in 2005, while the average subsidized policy cost $710. The corresponding full-risk premium for that subsidized policy would be roughly two and a half times that amount, or almost $1,800 (see Table 1). The greater risk associated with subsidized properties is illustrated by partial data on properties damaged by Hurricane Katrina: Roughly 122,000 of the 200,000 damage claims reported to FEMA by November 30, 2005, or 61 percent, were for subsidized properties.[3]

Those premium rates and percentage subsidies are averages; the full-risk premium for any individual structure depends on the local flood risk, the structure's elevation, and its insured value. In fact, many pre-FIRM properties are on high enough ground that the actuarial premiums would be lower than the pre-FIRM rates, which do not take the elevation of individual properties into account—in other words, the "subsidies" are negative. In those cases, the property owners can lower their premiums, as many have done, by certifying their elevation and choosing to be rated on the post-FIRM schedule.[4] Conversely, full-risk rates for those structures at the lowest elevation relative to the local floodplain would be as much as 10 times higher than the subsidized rates.[5]

Table 1.

Flood Insurance Premiums and Subsidies

Type of Policy	Average Annual Individual Premiums: Actual (Dollars)	Actuarially Fair (Dollars)	Subsidy (Percent)	No. of Properties (Millions)[a]	Total Premiums in the Program (Billions of dollars): Actual	Actuarially Fair	Subsidy
Subsidized	710	1,775	60	1.2	0.9	2.1	1.3
Not Subsidized	340	340	0	3.4	1.2	1.2	0
Average or Total	**440**	**720**	**39**	**4.7**	**2.0**	**3.3**	**1.3**

Source: Congressional Budget Office based on information from the Federal Emergency Management Agency (FEMA).

Note: Numbers in the table do not always add up to totals because of rounding.

a. The numbers of insured properties are approximate, based on the total number of policies as of September 2005 and FEMA's November 2004 estimates of the distribution of types of policies in 2005.

Using FEMA's 2005 figures on the average subsidy and the relative shares of subsidized and actuarially based policies, CBO estimates that the NFIP collects only 61 percent of the premiums required for long-run actuarial balance. Based on the $2.0 billion in premiums from 2004, the percentage implies an aggregate subsidy of $1.3 billion.[6] That estimate assumes that FEMA's actuarial tables are correct,

[3] Those data indicate that subsidized policyholders filing claims after Katrina represent at least 10 percent of all subsidized policyholders nationwide.

[4] A study using data from 1998 estimated that, out of a total of 4.4 million insured and uninsured pre-FIRM structures nationwide, 1.9 million (44 percent) would cost less to insure under post-FIRM rates; see PriceWaterhouse Coopers, *Study of the Economic Effects of Charging Actuarially Based Premium Rates for Pre-FIRM Structures* (prepared for the Federal Emergency Management Agency, May 14, 1999), p. 5–4. That share may have fallen since then, if more policyholders in that situation have switched to the post-FIRM rate schedule.

[5] Ibid., p. 5–5.

[6] The Center on Federal Financial Institutions made the same calculation last fall; see *Federal Flood Insurance After Katrina,* p. 8, available at *www.coffi.org.*

and thus it does not include any hidden subsidy on (or surplus from) the post-FIRM properties. Nor does it reflect the cost to taxpayers of bearing the risk of the insurance contracts. Ideally, one would estimate the economic subsidy, which includes not only the actuarial subsidy but also the amount required to compensate taxpayers for their risk exposure. CBO has done such estimates in other contexts, in analyzing a loan guarantee to America West Airlines, for example.[7] Estimating the cost of risk is difficult, however, and in the case of the NFIP, further analysis would be required before CBO could say whether the risk premium is small or large relative to the estimated actuarial imbalance of $1.3 billion per year.[8]

The Effects of Reducing or Eliminating the Subsidies

The Congress could choose to modify the NFIP's rate structure to reduce or eliminate the current explicit subsidies. The qualitative responses of policyholders to changes in those subsidies are clear: Some policyholders would reduce their amount of coverage, and others would drop their flood insurance entirely—in either case leaving themselves more exposed to future flood risks. Reducing or eliminating coverage would probably be more common among voluntary purchasers, but compliance by people whose mortgage requires them to maintain full coverage might decrease.

Quantifying those responses by policyholders is difficult, however.[9] CBO has identified three studies that analyze the sensitivity of demand for flood insurance, one of which has been published in a peer-reviewed journal.[10] That study, which examined aggregate State-level data for 1984 through 1993, looked separately at the numbers of flood insurance policies and the dollars of coverage in force. The study estimated that the price elasticity of demand for policies was –0.11 and the elasticity for dollars of coverage was –1.0, implying that a 10 percent increase in price would lead to about a 1 percent decrease in the number of policies and a 10 percent decrease in coverage.

The applicability of those estimates to the questions of interest here is uncertain, however. Major reductions in the existing subsidies would translate into large increases in premiums—and in many cases, those premiums would be well outside the range of the study's pre-1994 data. So the study's results may greatly understate the extent to which policyholders would drop their coverage. Conversely, two factors suggest that the results may overstate the sensitivity of demand to changes in the subsidies. First, the requirement making the purchase of flood insurance mandatory for some property owners has been expanded and become better enforced since the period covered by the study. Second, the changes in premiums would apply only to the first tier of coverage, so policyholders with coverage extending into the unsubsidized tier would see no increase in prices, and hence no increased incentive to reduce their coverage, within that second tier.

With those qualifications, CBO has assessed the implications of the study's estimates: If premiums on all subsidized policies were raised 150 percent, which is the average amount needed to eliminate the subsidies entirely, about 10 percent of the previously subsidized policyholders would drop out of the program, total coverage in force would fall by about 60 percent, and total revenues from premiums would remain essentially unchanged.[11] But those projections should be interpreted with caution, in light of the questions about the applicability of the study's analysis.

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[7] Congressional Budget Office, *Estimating the Value of Subsidies for Federal Loans and Loan Guarantees* (August 2004).

[8] On the one hand, the fact that reinsurers include substantial "risk loads" in the premiums they charge for policies covering natural disasters suggests that the risk cost of the NFIP is high. On the other hand, the fact that the risk of catastrophic flooding in the United States has little correlation with the performance of the national or global economy (unlike, say, the risk of widespread bank failures), and hence is relatively diversifiable, suggests that the program's risk cost is low.

[9] The PriceWaterhouse Coopers study in 1999, cited earlier, addressed just that question; but notwithstanding the extensive effort by the study team to identify sample communities and collect data on the age, elevation, presence of basements, and other characteristics of thousands of structures, the study's results rested on very slight evidence about policyholders' response to price changes. In particular, the study relied on a single estimate of price sensitivity from a 1983 analysis by the General Accounting Office (now the Government Accountability Office).

[10] Mark J. Browne and Robert E. Hoyt, "The Demand for Flood Insurance: Empirical Evidence," *Journal of Risk and Uncertainty,* vol. 20, no. 3 (2000), pp. 291–306; Warren Kriesel and Craig Landry, "Modeling the Decision to Buy Flood Insurance: Results from 62 Coastal Communities," available at *www.agecon.uga.edu/faculty/wkriesel/PDFfiles/section3.pdf;* and General Accounting Office, *The Effect of Premium Increases on Achieving the National Flood Insurance Program's Objectives,* GAO/RCED–83–107 (February 1983).

[11] For there to be a 60 percent reduction in the amount of coverage in force with only a 10 percent decline in the number of policies, the average coverage among those who maintain their policies must fall by about 56 percent.

The impacts on the NFIP's soundness and the Federal budget are somewhat easier to predict. If the subsidies were eliminated, estimates of what would happen to the number of policies or the coverage in force, or even to total premiums, would not be necessary because each remaining policy would be pulling its own weight, actuarially. Thus, eliminating the subsidies would eliminate the actuarial imbalance in the flood insurance program, which, as mentioned, is estimated to be about $1.3 billion per year. Estimating the annual savings from a smaller reduction in subsidies would be more complicated, involving questions about which groups of policyholders would drop or reduce their coverage, but the result would be less than $1.3 billion. Net savings to the Government would be smaller than those to the NFIP, to the extent that future floods would lead the Congress to appropriate a greater amount of Federal disaster assistance in response to a greater number of uninsured flood victims. Historically, the levels of assistance provided to disaster victims have not been so large that they would entirely offset the savings to the NFIP.

Budgeting and Policy Choices for the NFIP

The Congress faces important policy choices about flood insurance that can be informed by the budgetary treatment of the NFIP. For example, as the Congress considers the program in light of the catastrophic hurricanes of 2005, it faces choices about whether to continue to provide subsidies to NFIP policyholders or to charge actuarially fair rates. Other policy choices include whether to try to recover the funds borrowed to pay for the claims from last fall's hurricanes, whether to expand the reach of the requirement to purchase flood insurance, and whether more should be done to reduce the Nation's exposure to flood risks. Arguments can be made on either side of those issues, but they are ultimately policy decisions for the Congress.

To make informed decisions about the NFIP and the benefits that it provides, the Congress needs good information about the program's costs. FEMA's actuarial analysis, Federal budget data, and CBO's baseline projections and cost estimates for legislation are various means of communicating such cost information. Currently, the Federal budget displays the NFIP's financial results on a year-by-year cash basis, and CBO prepares baseline projections for the NFIP on that same basis, estimating the program's annual flows of funds. But because the NFIP is an insurance program, that budget presentation does not necessarily convey the Government's exposure to risk over the long-term.

Estimates of both the cashflows and long-term subsidies provide valuable perspectives on the NFIP, and, ultimately, the Congress needs both kinds of information. The relevant question about budgetary treatment—a question that can be asked not only about the flood insurance program but also about other Federal insurance programs—is which of the two types of information is most useful to include in the budget. But the budgetary treatment can only inform the policy decisions; regardless of the presentation used, central questions such as whether, and to what extent, the Government should subsidize flood insurance will remain.

Budgeting for Insurance Under Current Law

The Federal budget records the transactions of the flood insurance program on a cash basis. Specifically, income from premiums and fees for policies in force is recorded as offsetting collections (negative outlays), and payments for flood insurance claims and administrative costs are recorded as outlays. Actual results for each year and the Administration's budget for the coming year appear in the budget on a cash basis. CBO's baseline projections currently reflect the agency's best estimate of net spending for the program—taking into account claims, other expenses, and collections of premiums—on a cash basis. In the short-run, particularly for the current year, estimates reflect anticipated costs that are heavily influenced by events that have already occurred. As such, CBO's January 2006 baseline projects unprecedented levels of net spending in 2006 as claims from last fall's devastating hurricanes are settled.

Because CBO cannot estimate the timing or magnitude of future floods, projections for years beyond 2007 represent estimates of net spending based on past experience. Historically, the fund has ended most years with either a modest surplus (that is, net receipts) or modest net spending. On the basis of those results and the inherent unpredictability of major floods, CBO's estimate of the most likely amount of net spending for any particular future year, on a cash basis, is zero.

Zero is not the best estimate of the long-term costs of the program, however, because the program does not collect sufficient premiums to cover actuarially expected losses. As I noted earlier, on the basis of FEMA's data, CBO estimates that the subsidy built into the program totals $1.3 billion annually. However, FEMA does not have sufficient borrowing authority to support net spending of $1.3 billion in every year. So in the context of a cash budget, baseline projections must be consistent with that borrowing constraint, and, therefore, they cannot show the full estimated subsidy in all years.[12]

In short, cash-basis accounting for flood insurance has the advantage of being simple and of accurately recording past receipts and payments from the fund. But cash-based estimating does not provide an accurate picture of expected long-term costs for this program.

An Alternative Approach: Budgeting Subsidy Costs

To obtain better information about the cost of providing subsidized insurance, the Congress could specify changes to budget process law that would require CBO and the Administration to record spending and prepare projections for flood insurance on a noncash basis.[13] The Federal Credit Reform Act specifies particular accounting treatments for Federal credit programs that could serve as a model for an alternative approach for insurance programs. The analogy between the flood insurance program, which provides year-to-year policies, and credit programs that offer long-term loans or loan guarantees is not perfect; but the credit reform approach of trying to capture expected costs may be a useful model to consider for the budgetary treatment of the NFIP. The approach would require that the cost of subsidizing flood insurance be recorded each year. Under that approach, CBO and the Administration would estimate the projected premiums and costs, and the expected net losses (or gains) would appear as outlays (or collections) in the budget and would be reflected in projections of the budget deficit.

Specifically, the budget would record historical results and estimates of actuarial imbalances when coverage was sold.[14] Under that type of treatment, baseline projections for the program would show net spending equal to an estimate of the subsidy—currently $1.3 billion—in every year that the program was assumed to operate. That estimate would generally not be updated at the end of the fiscal year to reflect actual net spending. A reestimate would be made only if the year's experience provided evidence that the distribution of possible flood events was different from what was previously thought. In such cases, the budget would record reestimates of the subsidy that reflected changes in estimates of actuarial costs. In years without such reestimates, the budget would record net spending equal to the estimated subsidy. The actual cashflows would be tracked separately in a nonbudgetary account.

Adopting a subsidy-cost basis for presenting the NFIP in the budget offers the primary advantage of providing a clear display of the average expected cost of the program. It also offers the prospect of more explicit Congressional control of the program's cost.

Such an approach has some disadvantages, however. Perhaps most important is the intrinsic difficulty in projecting future insured losses from catastrophic floods. Correspondingly, a subsidy-cost treatment of the NFIP does not reflect the fact that borrowing authority would still be needed to pay losses during some catastrophic years even if subsidies were eliminated. In addition, a subsidy-cost approach could result in reestimates if significant new information about flood risks was acquired. Finally, the analytical complexities of subsidy-cost accounting for flood insurance would create new demands on the budget process.

[12] The existence of the borrowing limit also may influence the budgetary impact of proposals to change the NFIP. The program is currently estimated to owe about $5 billion more in claims than it has the legal authority to pay (by borrowing from the Treasury)—implying that new collections of premiums or fees might have to be used to pay some of the outstanding claims, not to reduce the deficit.

[13] Most procedures that specify how to construct baseline and legislative estimates are contained in the Balanced Budget and Emergency Deficit Control Act and the Congressional Budget and Impoundment Control Act.

[14] Incorporating estimates of the actuarial subsidy in budget presentations would not in itself account for the cost of risk to taxpayers. Even under actuarially fair rates, the NFIP would transfer risk from policyholders to the Federal Government and ultimately to taxpayers. The cost of that risk can be interpreted as the amount that private reinsurers in a competitive market would charge to assume it.

RESPONSE TO A WRITTEN QUESTION OF SENATOR DOLE FROM DAVID M. WALKER

Q.1. The National Flood Insurance Program was created in 1968 to help families afford flood insurance because it was too expensive. Is flood insurance now affordable in the private market? Do private insurance companies offer flood insurance for families that live in a 100-year-floodplain?

A.1. Flood insurance is not considered profitable within the private-sector insurance industry, and no major markets other than the NFIP exist through which flood insurance can be purchased. A June 2005 report by the Congressional Research Service found that flood insurance was once sold in private markets in the United States, but has not been available for many years. During the late 1920's several dozen fire insurers sold flood insurance, but after river flood disasters in 1927 and 1928, they withdrew from the market. By the late 1950's, flood insurance was virtually unavailable from the private insurance markets because insurers could not profitably sell coverage at an affordable price due to the catastrophic nature of flooding and insurers' inability to develop actuarial rates that reflected the flood hazard risk. Currently, according to a FEMA Mitigation official, Lloyds of London offers flood insurance in excess of NFIP policy limits primarily to businesses. In addition, this official was aware of one U.S. insurance company that sold flood insurance policies, but among other restrictions, no policies are sold for properties located in the 100-year-floodplain.

RESPONSE TO WRITTEN QUESTION OF SENATOR REED FROM DAVID M. WALKER

Q.1. There are a number of reasons so few homeowners buy flood insurance, including lack of knowledge and misunderstanding of the National Flood Insurance Program (NFIP). Does GAO have any suggestions on how to improve participation in the NFIP?

A.1. We have also been told by FEMA officials and insurance practitioners that a reason homeowners do not buy flood insurance unless they are required to do so is because they do not believe their properties will be flooded. These homeowners choose not to spend money on flood insurance premiums or do not have the income to pay the premiums. The very term "100-year-floodplain" may lead homeowners to minimize their risk of flooding. Homeowners who live in a 100-year floodplain statistically have one chance in a hundred of being flooded in any given year; however, there is a 30 percent chance of being flooded over the life of a 30-year mortgage. Premium amounts for NFIP policies vary according to the amount of coverage purchased and the locations and characteristics of the property to be insured. In June 2005, the average yearly premium for a 1-year policy was $446. FEMA officials reported to us that they have observed a yearly cycle in the purchase of NFIP policies in which the policies in force increase slightly during each hurricane season when reports of flood damage are in the news. At the end of the hurricane season, policies begin to level off or decline until the start of the next hurricane season.

In our testimony, we noted that FEMA and its private-sector partners have a marketing campaign called "Flood Smart" underway to attract new NFIP policyholders and improve rates of renewal. Marketing elements being used include direct mail, national television commercials, print advertising, and websites designed for customers and insurance agents.

According to FEMA officials, in a little more than 2 years since the contract began, net policy growth improved a little more than 7 percent and policy retention improved from 88 percent to 91 percent. However, we also note there have been incremental increases in policies in force during most years throughout the history of the NFIP.

In our ongoing work, we plan to obtain additional information on the costs and benefits of the Flood Smart campaign and other actions, if any, that should be considered to increase the number of NFIP policies in force. In addition, we will look at data on policies in force to assess whether more purchases and renewals are made as a result of the devastating hurricane seasons over the last 2 years.

Q.2. GAO reported, in June 2002, that the extent to which lenders were enforcing the NFIP's mandatory purchase requirement was unknown since Federal bank regulators believed lenders were generally complying, while FEMA officials believed that many lenders were not complying with the requirements. Since the rate of compliance is an important component in the discussion to further expand mandatory purchase requirements, how do you propose we accurately measure compliance with this existing requirement?

A.2. As part of our ongoing work, we are analyzing what changes could be made to the NFIP to increase revenues, reduce costs, or otherwise make the program more financially sound. Certainly one part of this analysis will be to revisit the compliance issue and its potential to increase the amount of premiums paid into the NFIP. A starting point for us will be to review the results of two recent reports. FEMA contracted with the American Institutes for Research (AIR) to do a comprehensive evaluation of the NFIP, which is expected to be fully completed in December 2006. In March 2005, AIR released its study of the NFIP's mandatory purchase requirements entitled, "The National Flood Insurance Program's Mandatory Purchase Requirement: Policies, Processes, and Stakeholders." Among the recommendations made by the study was that NFIP develop a system that permits a comprehensive and ongoing assessment of the level of lenders' and borrowers' compliance with the mandatory purchase requirement.

In December 2005, the RAND Corporation released a report on "market penetration" by the NFIP entitled, "The National Flood Insurance Program's Market Penetration Rate: Estimates and Policy Implications." The report focused on flood insurance coverage for single family homes. The report estimated that nationally about 49 percent of single family homes in special flood hazard areas—the 100-year-floodplain—had NFIP policies. The report also estimated that although about one-third of NFIP policies were for properties outside special flood hazard areas, these policies represented about 1 percent of properties outside the boundaries of the special flood hazard areas. The report also estimated that about 60 percent of single family homes in special flood hazard areas are in the South.

While estimating that the compliance rate with the mandatory purchase requirement was highest in the South and West (80 percent or more), the report noted that data limitations precluded developing precise estimates about compliance with the mandatory purchase requirement. The report concluded that many complex considerations needed to be addressed in setting goals for policy growth and market penetration rates, and that financial regulators and NFIP managers should evaluate whether and how to improve compliance with the mandatory purchase requirement in various submarkets and areas of the Nation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DOLE FROM DAVID I. MAURSTAD

Q.1. As I mentioned at the hearing, North Carolina has excellent flood maps due to our advanced flood mapping program. How many other States have maps that detail their 500-year floodplain? What percentage of flood maps detail the 500-year floodplain?

A.1. FEMA commonly assesses its mapping activities regarding the 500-year floodplain by considering the total number of steam miles for which 500-year floodplains have been mapped.

The following table shows the top 12 States and Territories, along with the District of Columbia, ranked by the percentage of stream miles having a mapped 500-year floodplain.

Ranking	State	Percent of Stream Miles with 500-Year Floodplain
1	District of Columbia	90
2	New Jersey	45
3	Delaware	42
4	Rhode Island	39
5	Massachusetts	39
6	Maryland	35
7	Louisiana	33
8	Connecticut	33
9	Florida	26
10	North Carolina	21
11	Puerto Rico	21
12	South Carolina	17

It should be noted that some portion of the total 500-year floodplain has been identified in each State. North Carolina has approximately 65,000 miles of stream. Of that total, approximately 13,600 miles have a mapped 500-year floodplain, which translates into approximately 21 percent of North Carolina streams mapped.

Q.2. Of that percentage of maps that detail a 500-year floodplain, how much is in North Carolina?

A.2. Approximately 4.2 million miles of streams exist in the United States. FEMA has mapped a 500-year boundary for approximately 230,000 stream miles. Many of the Nation's stream miles are located in large Federal holdings that may never need to be studied. North Carolina currently has approximately 13,600 miles of stream with mapped 500-year floodplain boundaries. Of FEMA's total inventory of the Nation's mapped 500-year boundaries, 5.9 percent are located in North Carolina.

Q.3. Can FEMA implement a 500-year floodplain policy requirement in States with maps that do not detail these areas?

A.3. All States have areas where the 500-year floodplain has not been mapped. FEMA could not implement a mandatory flood insurance purchase requirement in these areas until they were studied and flood maps were prepared. Additionally, all existing 500-year floodplain mapping should be reviewed and its accuracy confirmed before it is used as the basis for the mandatory purchase of flood insurance.

Q.4. Do you believe that implementation of a 500-year floodplain purchase requirement reform would disproportionately affect North Carolina?

A.4. The implementation of the 500-year floodplain purchase requirement would be beneficial to the Nation's population at flood risk, including those in the State of North Carolina, because they would be protected against flood losses to their homes and businesses. FEMA is prioritizing the national mapping effort to focus on areas at flood risk including the State of North Carolina.

By the end of Flood Map Modernization, it is estimated that 90 percent of the Nation's flood risk will have been mapped based on factors such as population, flood history, growth potential, and other similar characteristics. Specifically, it is now estimated that at the end of Map Modernization:

- Digital flood map products will be available for 92 percent of the Nation's population.
- Thirty percent of the stream miles mapped will be based on new, updated, or validated engineering analyses, affecting 40 percent of the Nation's population.
- Eighty percent of Nation's population will have maps that encompass stream miles that meet the 2005 Floodplain Boundary Standard. The 2005 Floodplain Boundary Standard sets forth a refined mapping standard for depicting the floodplain boundary to match the best available topographic data.

Because the application of the 2005 Floodplain Boundary Standard is aligned to flood risk, areas of moderate to high population density and anticipated growth within the floodplain will have the 500-year floodplain boundary identified.

Currently, the State of North Carolina, which is nearing completion of its Map Modernization efforts, has 5.9 percent of the Nation's total inventory of mapped 500-year floodplain boundaries. If the 500-year floodplain mandatory purchase requirement were implemented at this stage of the total nationwide Map Modernization effort, North Carolina could appear to be disproportionately impacted. This is because the State has been proactive in contributing to and delivering updated digital flood hazard maps sooner than other areas of the Nation. However, as FEMA continues its Map Modernization efforts, the amount of the Nation's mapped 500-year floodplain boundary inventory in other States will increase. By the end of Map Modernization, we do not anticipate that the State of North Carolina will have been disproportionately affected by the 500-year floodplain mandatory purchase requirement.

Property owners in the State of North Carolina will benefit from the availability of updated flood hazard information, including the 500-year floodplain boundary, which reflect their flood risk and enable proper flood insurance rating. Property owners in the 500-year floodplain would purchase flood insurance at rates lower than those located in the 100-year floodplain. Since floods also occur in lower risk areas, and can have devastating effects on individuals and communities, these property owners will have the benefit of the protection that the National Flood Insurance Program provides.

Q.5. If we raise the premium rate increase cap to 25 percent in the year following the increase how much will the average premium rise for families living in a 100-year floodplain? In addition, how much of an increase would you expect in the second and third years?

A.5. For rating purposes, the National Flood Insurance Program's (NFIP) primary differentiation for structures in the 100-year floodplain is between structures built before a community joined the NFIP (known as pre-FIRM structures), and structures built after a community joined the NFIP (known as post-FIRM structures). Post-FIRM structures are charged full-risk premiums. As such, these structures will continue to see modest increases in order to keep their premiums current with inflation.

Rate increases for pre-FIRM structures would be determined in consultation with FEMA's Congressional authorizing Committees. If it is the intent of Congress that FEMA quickly and significantly reduce the amount of subsidy, then FEMA would implement a series of 25 percent increases for these structures. On average, owners of pre-FIRM structures currently pay approximately $800 annually for their flood insurance policies. Such a series of increases could result in the average premium increasing to $1,000 the first year, $1,250 the second year, and $1,550 the third year. However, as these premium increases are implemented, no pre-FIRM structure would be required to pay more than their full-risk premium.

Q.6. With a 25 percent rate increase cap how many 25 percent rate increases will it take to get to a nonsubsidized rate?

A.6. The full-risk premium for pre-FIRM structures varies depending on how far below the Base Flood Elevation (also known as the 100-year flood level) the structure is located. Some pre-FIRM structures will be at full-risk premiums after the first rate increase. Other structures are at much greater risk of flooding and will require a series of increases to reach the full-risk premiums. FEMA estimates that by the fifth increase, more than 90 percent of the current pre-FIRM structures will be at full-risk premiums.

Q.7. Does FEMA believe that raising the rate increase cap indicates that Congress wants to end the practice of providing lower flood insurance rates to families living in a floodplain?

A.7. FEMA will consult with its authorizing Committees in order to determine the intent of Congress on this issue. Without explicit direction to discontinue the subsidy, it appears that Congress' intent is a major reduction in the amount of subsidy provided, not a complete elimination of that subsidy. If that is the direction FEMA receives from the oversight Committees, the agency will work with those Committees in determining the proper level of the future subsidy.

Q.8. Is flood insurance currently available at market rates from private companies for families living in a 100-year floodplain? If so what companies offer it and what is the average yearly premium they would charge?

A.8. Non-NFIP flood insurance may be available from various insurance companies for families that live in certain special flood hazard areas (SFHA's), as well as in nonparticipating communities and Coastal Barrier Resource Areas. FEMA does not maintain detailed information on all such companies, nor the premiums that they charge. However, it is FEMA's understanding that the main provider is Lloyds of London. AIG and Chubb also offer primary flood insurance, but they may limit sales to certain non-SFHA's.

Q.9. Last year, we doubled the funding for mitigation grants in the reauthorization bill. With 200,000 claims expected from 2005 will FEMA also require additional funds to expand these mitigation efforts in the Gulf Region?

A.9. At this time, FEMA is providing technical assistance to the Gulf Coast communities with preparation of their Mitigation Plans to ensure that mitigation grants are effectively targeted and consistent with State and local priorities. Local mitigations plans, in conjunction with State-established mitigation priorities, will help direct necessary grant funds to the most cost effective projects. States set mitigation priorities and select project applications that are developed and submitted by local jurisdictions. Funds will be obligated though FEMA's portfolio of hazard mitigation assistance programs which include the Flood Mitigation Assistance (FMA), Pre-Disaster Mitigation (PDM), Hazard Mitigation Grant Program (HMGP), Severe Repetitive Loss (SRL), and the Repetitive Flood Claims (RFC) Programs. Since many projects are still in the planning or development phase, FEMA does not yet know what the total financial requirements are, or the States' ability to provide the required match, and will continue to monitor community needs as recovery moves ahead.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM DAVID I. MAURSTAD

Q.1. I am very concerned that FEMA's maps do not accurately reflect flood hazards in communities, especially by failing to include storm surge and coastal inundation information from the Army Corps of Engineers and the National Oceanic and Atmospheric Administration. In my State, the FIRM's are 20-years-old so they also do not reflect the effects that new development and erosion may have on flooding. What steps are FEMA taking to improve the FIRM's, including putting the maps on the web in a user-friendly manner?

A.1. FEMA's Flood Map Modernization effort will transform the Nation's flood maps into more reliable, easier-to-use, and readily available maps. The mapping effort uses state-of-the-art technology and advanced engineering to streamline studies and improve results, and improve data quality and accessibility, including production of flood maps in Geographic Information System (GIS) format.

Map Modernization will allow community planners and local officials to gain a greater understanding of the flood hazards and risks that affect their community, and provide builders and developers with detailed information for making decisions on where to build and how construction can affect flood zones. In addition, home and business owners will be able to make more informed decisions about their flood risks.

FEMA regularly incorporates storm surge and coastal inundation information into map updates, including data from sources such as the U.S. Army Corps of Engineers (USACE) and the U.S. Department of Commerce's National Oceanic and Atmospheric Agency (NOAA). FEMA-funded storm surge studies are currently in production for the entire Texas, Louisiana, and Mississippi coasts using the most up-to-date models and data available. The USACE is performing two of the three studies, and a private-sector engineering firm is performing the third. Coordination with NOAA is an important and ongoing component of all three studies. In addition, FEMA is developing a National Coastal Strategy to help prioritize study of the entire U.S. coastline as part of planning for future coastal flood hazard updates. High-risk areas with outdated flood hazard maps will be prioritized for updates.

As part of Map Modernization, countywide Flood Insurance Rate Map (FIRM) updates are in progress for all five counties in the State of Rhode Island. The results of these efforts will also include consideration of storm surge data and coastal flood hazard data, including the flood hazard information collected as part of the wave height/runup study performed for the Narragansett Bay in Bristol County in 1992.

Please note that any interested party may request that their community officials submit a map revision request to FEMA in accordance with Part 65 of the National Flood Insurance Program (NFIP) regulations. To assist communities in compiling all the data required to support map revision requests, FEMA has developed easy-to-use, step-by-step instructions and forms. These instructions and forms are contained in the MT–2 application forms package, available on FEMA's website at *www.fema.gov/pdf/fhm/mt–2.pdf*. Upon receipt of the community's map revision request, FEMA will review the completed forms and the required data and, if appropriate, revise the FIRM, either by physically revising and reissuing the FIRM, or by issuing a Letter of Map Revision (LOMR). The LOMR, which would become effective on the date it is issued by FEMA, has the effect of revising the FIRM without physically revising and reissuing the affected FIRM panel(s).

Additionally, the online FEMA Flood Map Store is available at *http://store.msc.fema.gov*. Users may research, view, and purchase the available inventory of effective NFIP products, including Flood Insurance Study reports, FIRM's, and other mapping products. A user can also create a customized FIRMette—a paper copy of a user-defined portion of an effective FIRM, produced on the user's computer. After selecting the State, county, and community name, the user chooses the panel to be viewed, selects standard paper size, defines the area to be printed, and selects whether the FIRMette will be created as an Adobe PDF or TIFF image. The user then can save the FIRMette to his or her own computer, open it from the viewer, and print the image. The FIRMette is true to scale and includes title block, scale, and north arrow. It can be used to help determine the location of a property or structure relative to Special Flood Hazard Area (SFHA's), which are land areas at high risk for flooding.

Q.2. According to the study recently released by the National Institute of Building Sciences, each dollar spent on disaster mitigation saves an average of $4. What further mitigation strategies does FEMA intend to implement?

A.2. In addition to FEMA's portfolio of hazard mitigation assistance programs which include the Flood Mitigation Assistance (FMA), Pre-Disaster Mitigation (PDM), Hazard Mitigation Grant Program (HMGP), Severe Repetitive Loss (SRL), and the Repetitive Flood Claims (RFC) Programs, the Mitigation Division administers and oversees the Nation's floodplain management program for over 20,000 communities. The National Flood Insurance Program (NFIP) has played a critical role in encouraging communities to adopt and enforce floodplain management regulations, implement broader floodplain management programs, and foster adoption of strong building codes. These floodplain management requirements are the most cost effective way to reduce the flood risk to new buildings and infrastructure. Structures built to NFIP requirements experience 80 percent less damage than structures that are not built to these standards, which nationally results in $1.2 billion per year in reduced flood losses.

FEMA's Mitigation Division is working closely with States and local communities to implement effective mitigation practices and to promote sound planning and recovery decisions, especially in those areas most vulnerable to future hazard events. For example, in response to requests for updated rebuilding guidance from State and local officials in Mississippi and Louisiana following hurricanes Katrina and Rita, FEMA took the unprecedented step of immediately assessing existing flood risk data and issuing updated and more accurate advisory guidance to help speed the recovery.

The flood recovery guidance documents released to impacted counties and parishes in Mississippi and Louisiana as of April 2006 provide Advisory Base Flood Elevations (ABFE's), which are an interim product to provide communities with the best available data to assist with their rebuilding efforts while new preliminary Flood Insurance Rate Maps (FIRM's) are being completed. FEMA is working to expedite the production of the preliminary FIRM's. The agency continues to work closely with its mapping partners on the development of new storm surge modeling that will serve as the foundation for the updated flood maps. FEMA is on schedule to deliver preliminary FIRM's to Louisiana and Mississippi communities for comment by the end of this calendar year. These preliminary FIRM's will begin the formal process that will eventually result in final, updated Flood Insurance Rate Maps.

FEMA requires States and communities to use the ABFE's for federally funded mitigation and recovery projects, and strongly encourages States and local communities to use the ABFE's in making reconstruction and elevation decisions. Through the adoption of stricter requirements and by building higher and stronger, communities will be able to ensure a greater level of protection to homes and businesses during future storm events. These mitigation strategies will be evaluated for use on a nationwide basis.

Mitigation planning is critical to the future viability of vulnerable communities. FEMA continues to coordinate the mitigation planning process with long-term community recovery planning that is already underway. For example, FEMA is asking communities to meet or exceed the local mitigation planning requirements identified in FEMA regulations [44 CFR 201.6]. FEMA will continue to assist local jurisdictions in implementing the planning process to update existing risk assessments and to make use of the latest available hazard information in developing mitigation plans.

Finally, mitigation assessment teams have worked closely with State and local officials to evaluate and recommend improved building design and construction techniques, advocate new building codes and enforcement measures, and suggest mitigation activities that will improve community-wide disaster resistance during future events.

Q.3. What steps is FEMA taking to help communities prepare for next year's hurricane season? Has education of homeowners been increased? Have mandatory purchase requirements been enforced?

A.3. Property owners across the United States learned from the hurricane seasons of 2004 and 2005 that the consequences of flooding can be devastating, and that too many Americans lack adequate protection from flood damage to their homes and businesses. Two years ago, in an effort to increase awareness and educate homeowners about their flood risk and the importance of flood protection, FEMA's National Flood Insurance Program (NFIP) launched an integrated marketing effort that includes public relations (PR), direct response advertising, website development *(www.floodsmart.gov),* and an online marketing campaign known as FloodSmart. As the 2006 hurricane season approaches, the primary goal of FloodSmart is to continue and increase efforts to inform residents about their flood risk and available options for flood insurance protection.

The NFIP's message this hurricane season is simple and direct: Homeowners and business owners in the country's highest risk areas, designated special flood hazard areas (SFHA's), should be protected with a flood insurance policy. In addition, the NFIP continues to reach out to residents who, although they live outside of the highest risk areas, are still at risk for flooding. Floods can happen anywhere, at anytime, and the FloodSmart campaign is working to spread this message by encouraging all Americans to learn their risk and protect their families and homes from flood damage.

NFIP's targeted effort to communicate the importance of flood insurance protection to residents in hurricane-prone areas will begin on May 1, 2006. There is a 30-day waiting period for new policies to take effect. Launching these efforts on May 1, 2006, will underscore the need to purchase flood insurance in advance of hurricane season, which begins on June 1, 2006.

Ongoing campaign efforts include direct-to-consumer outreach through a direct mail campaign to property owners in high, moderate, and low flood risk areas, advertisements in national publications, television commercials, information posted on the FloodSmart website, and online advertisements. The campaign also continues to aggressively reach out to the media with important tips and information about the NFIP, including targeted messages and what property owners can do before, during, and after a flood to reduce or eliminate their risk.

The NFIP is working closely with the insurance industry, community leaders, and industry stakeholders to educate Americans about the effects of hurricanes and the risk of floods beginning in May 2006, and continuing throughout hurricane season. Toolkits of flood insurance outreach materials, industry-related conference outreach, and consistent communications efforts have helped the NFIP develop and expand critical partnerships with State associations, insurance agents, and other key stakeholders and influencers. In turn, these partners have become engaged in the FloodSmart program and consistently communicate the importance of flood insurance investment in their local communities.

The NFIP has taken steps to support flood insurance education and hurricane preparedness in the Gulf Coast region and other areas greatly affected by the 2005 storms. The NFIP supports FEMA's Joint Field Offices and Departments of Insurance in Mississippi and Louisiana with messaging to educate local residents about flood risk and protection. The program also provides counseling and outreach support for the "Stay Alert, Stay Alive" campaign, an 8-week awareness effort initiated by Mississippi's State and local governments.

A cornerstone of the FloodSmart campaign during the past 2 years has been its focus on building and enhancing programs to support insurance agents with informational tools to help them communicate with their clients about the importance of flood insurance coverage. In addition to *www.floodsmart.gov,* which has become a key destination for flood and flood insurance information by media and consumers, the campaign has recently developed an agents-only section filled with audience-focused materials and resources at *agents.floodsmart.gov.*

The increased education and awareness through FEMA's FloodSmart campaign, in preparation for the upcoming hurricane season and continuing throughout the year, is critical to lessening the impact flood disasters have on peoples' lives across the Nation.

Last, regarding the enforcement of the mandatory purchase of flood insurance requirement, the Flood Insurance Reform Act of 2004 did not have a lender compliance component. Oversight for lender compliance with the laws applicable to the NFIP is placed on the Federal regulatory authorities responsible for the federally regulated lending institutions.

PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

THURSDAY, FEBRUARY 2, 2006

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

This morning, the Committee meets to hold its third hearing on the future of the National Flood Insurance Program. I believe it is important to briefly recapitulate some of the key issues from last week. The National Flood Insurance Program is currently bankrupt. Congress has increased the borrowing authority for the program to $18.5 billion and will need to increase that borrowing authority by several billion dollars more before the end of this month.

Under its current structure, the National Flood Insurance Program has no ability to pay even the interest on its current debt, let alone the principal. According to the Congressional Budget Office, 25 percent of the homes and businesses within this program, the very properties most susceptible to repetitive flooding, receive an explicit subsidy.

In testimony, the CBO valued the subsidy for this program at $1.3 billion per year. CBO also stated that since this program is not scored on the annual budget, no accounting is made for the subsidy that this program provides. Many of the preflood insurance program homes with the explicit subsidies have been bought and sold numerous times to individuals who knew full well that these properties were located in high risk flood areas.

We also learned that beyond the actuarial imbalances, the maps used to administer this program are grossly inadequate. As Senator Allard and others mentioned during the hearing last week, many of the flood maps used for this program are in excess of 20 years old. These maps are critically important, because they are used to determine the proper flood elevation for accurate height measurements for new construction and because they are used to determine the rate structure for the program. Without updating the flood insurance rate maps, I think it will be impossible to create an actuarially sound program.

It appears that the program has encouraged development in many low-lying areas where flooding is prevalent. Because of this, it appears that the program has initiated a vicious financial cycle for the taxpayer. The program fosters development in risky places; development leads to higher property values; higher property values lead to greater liability and bigger losses under the program. However, it does not stop after one round of losses; rather, the whole cycle begins anew after each payout. This may be good for business developers, but it is extremely costly for the taxpayers.

In our last hearing, we also learned that we need to have a better accounting of the use of premium dollars. Mr. Maurstad, who is the Acting Director of the Mitigation Division at FEMA, noted that of the $2 billion collected in premium income, roughly half is spent on administrative fees and expenses, which seems rather high.

Unfortunately, many of these issues are not novel concepts. In 1994, the GAO conducted a study on the National Flood Insurance Program and found the program was incapable of meeting its financial obligations in even minor catastrophic years. The current status of the flood insurance program only illuminates how accurate the GAO assessment was in evaluating the National Flood Insurance Program.

The events of 2004 and 2005 hurricane season and the forecast from the National Hurricane Center at our first hearing on this subject in October only reinforced how dire the need is to overhaul this program.

As I mentioned in last week's hearing, we do not have the luxury of doing nothing. We have today a very distinguished panel of witnesses, and I would like to welcome all of them to the Committee. Our panel this morning includes Mr. David Conrad, Senior Water Resources Specialist at the National Wildlife Federation; Ms. Regina Lowrie, Chairman, Mortgage Bankers Association; J. Robert Hunter, Director of Insurance, Consumer Federation of America; Mr. David Pressly, National Association of Homebuilders; Mr. Paul Gessing, Director of Government Affairs, National Taxpayers Union; Mr. David John, Research Fellow at the Heritage Foundation; and Ms. Pam Pogue, Chair, Association of State Flood Plain Managers.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

I want to join you in welcoming the witnesses before the Committee this morning. This is a further step in the series of hearings we have been holding on the flood insurance program which very clearly has some systemic problems. Actually, they became evident to me at least a few years ago when Hurricane Isabel struck the East Coast and revealed major administrative problems in the program. My constituents reported receiving unfair treatment and inadequate settlements from FEMA. FEMA was overwhelmed then, let alone the circumstance in which it now finds itself after one of the greatest natural disasters in our history.

Katrina drove over a million families from their homes, flooding hundreds of thousands of residences, and leaving tens of billions of dollars of destruction in its wake. The hearing we held last week, I thought, helped to put things in some perspective. The acting

Federal Insurance Administrator, David Maurstad, testified that prior to 2005, the largest loss year was 2004, and the flood insurance program paid out $2.2 billion in claims that year.

The average loss year, according to Maurstad, ran at about $1.2 billion a year. It is now estimated that Katrina and the other hurricanes in 2005 will result in almost $24 billion in flood insurance claims being paid. We need to raise the borrowing authority if they are to do that. I feel strongly that should be done. The people who took out these policies and made these payments and everything have a contractual right, actually, to be paid.

But this loss is 10 times the second highest loss year. It is 20 times the average loss year. And I put that out there because I think we need to keep it in mind, because I think there are two separate problems here, and I thought Comptroller General David Walker made that distinction at last week's hearing. One is how do we pay the $24 billion in claims from the 2005 storms, this unprecedented figure, 20 times the average loss year, 10 times the highest previous loss year? And the other issue is how to strengthen the program moving forward.

And we are going to talk a lot about actuarial rates and so forth and so on. I want to hear from the witnesses whether when they do that they are encompassing within the construct of an actuarial rate handling a $24 billion loss year; in other words, a storm of such magnitude that it far eclipses anything that has ever previously been recorded.

We have not settled yet how FEMA will pay for Katrina claims, although we have now raised the figure to $18 billion, and I think they estimate they will need roughly another $6 billion in order for the Federal Government to meet its contractual obligations to policy holders. As we explore this more and more, it is apparent it is quite a complex issue, and there are many things that need to be done to strengthen the flood insurance program.

Some of these witnesses have even raised the possibility of eliminating the flood insurance program. Mr. Hunter, who helped to put it into place and develop it, is now—it is either one way or the other as I understand his testimony, and I would be interested to draw him out on that as we proceed. But FEMA collects about $2 billion a year in premium income, so the order of magnitudes here are quite large when you get hit with something like Katrina.

I mean, it is beyond my understanding how you could encompass that within the premium structure, and I would be interested to hear from the witnesses on that particular point as well as many others.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you, very much, Mr. Chairman and Senator Sarbanes for holding this hearing on Reforming the National Flood Insurance Program, and I want to particularly welcome Pam Pogue from Rhode Island. Pam is our State's floodplain manager. She does a superb job for us, and we have been working with her on some of the legislation we have proposed.

And I also want to thank the Association of State Floodplain Managers and the National Wildlife Federation for endorsing my bill to modernize the FEMA flood mapping program. Thank you.

Mr. Chairman, I have a longer statement I would like to put in the record, but let me make a few points, if I may. Before 1989, no single coastal storm had caused insured losses greater than $1 billion in real terms, and since that time, Andrew, Wilma, Katrina, Rita, and others have caused damage in excess of $1 billion. This is no longer a minor event when one of these storms hits, and the reason, obviously, is that people are flocking to the coastlines.

Rhode Island is a great example of that. Twenty years ago, 30 years ago, summertime, you had beach houses along the coast. Now, there are multimillion dollar houses. They are demolishing the old houses to build the multimillion dollar ones. It is happening on the Maryland shore; it is happening on the Gulf shore. We have to be responsive to that.

We do have to have to modify the program. I believe the reforms must balance making the programs actuarially sound with insuring that American families living in these areas have access to affordable flood insurance. We also have to work closely, and FEMA has to take the lead, with respect to hazard mitigation programs. We understand these storms will come again, and we have to take steps now to minimize these billion dollar or more storm effects.

And I think finally, as has been said by the Chairman and others, we have to modernize the FEMA maps. The Corps of Engineers have inundation maps that are much different. They should be reconciled, and we should give information to local community zoning authorities, to local builders, and to individuals about exactly what the risks are, and these maps are important with respect to the overall program.

I hope the witnesses will discuss today whether the Federal Government programs such as Federal flood insurance, these programs are unintentionally giving the wrong incentives rather than the right incentives in terms of development along coastlines. But we all recognize the appeal of the oceans and the bays of this country are overwhelming, and as long as they are there, people will like to live close to them. I know I do; and we have to have a program that reflects that behavior and does so in a sound and prudent way, and I thank the witnesses for being here, particularly Pam.

Thank you.

Chairman SHELBY. Your written statement will be made part of the record without objection, Senator Reed.

Senator REED. Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Conrad, we will start with you. All of your written testimony, which is voluminous, will be made part of the record, and it is not only voluminous; it is very good, all of it.

Thank you, Mr. Conrad.

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

Mr. CONRAD. Thank you, Mr. Chairman.

Good morning, Mr. Chairman, Ranking Member Sarbanes, and Senator Reed. My name is David Conrad, and I serve as Senior

Water Resources Specialist for the National Wildlife Federation. We very much appreciate the opportunity to testify on this most important subject.

Mr. Chairman, the National Flood Insurance Program is indeed currently facing the most serious crisis in its 38-year history, we believe. The four major hurricanes which struck Florida put a major strain on the NFIP's solvency. Hurricanes Katrina, Rita, and Wilma have now demonstrated what has long been predicted, that the program's lack of an actuarially based financial structure leaves it vulnerable to major catastrophic losses, which can now only be repaid with enormous bailouts from the American taxpayers.

We do not believe that these should be viewed as isolated events that will not happen again. With a lack of accumulated catastrophic reserves, only $2 billion in annual revenues, the need to borrow in excess of $24 billion from the Treasury to pay claims and interest payments that will approach $1 billion from borrowing, it is clear that without a bailout, the NFIP would soon collapse.

We assume that some level of bailout will be provided but we strongly hope that Congress will take significant action concurrently to put the program on a much sounder footing. Improvements must be made financially in how, where, and at what price we provide insurance, and through a concerted effort to better manage risk. This requires a commitment to apply the best scientific methods of determining risk and best policy setting regarding where and under what circumstances we allow building in the vicinity of flood prone areas.

Mr. Chairman, in 1998, the National Wildlife Federation published a 3-year study that we conducted on the NFIP that showed that a relatively small group of properties, the repetitive loss properties, most of which received highly subsidized pre-FIRM rates, had up to that point experienced 25 percent of the losses and received 40 percent of total NFIP claims.

The enormous costs of these buildings, combined with continuing to insure them at highly subsidized rates and the fact that seldom was anything done to remove them from harm's way, meant that the NFIP continued to be far from actuarially sound and could never develop the needed reserves for catastrophic losses. As we heard last week from FEMA and GAO, these properties are continuing to be a large and chronic drain on the National Flood Insurance Fund.

We believe that a number of changes must be made to put the program on a sound footing: Reduction and elimination of subsidies, especially for pre-FIRM structures and repetitive losses is a long overdue reform that should be an urgent goal today. The belief when the program was first developed was that the high risk pre-FIRM properties would eventually be flooded and removed from floodplains, being replaced with structures outside the floodplain. This has proceeded far more slowly than anticipated, with the subsidies in fact working adversely to encourage a continual cycle of flooding and paying for flood damages.

It has been suggested that an initial step could be to eliminate subsidies for vacation homes, nonprimary residences, and commercial properties. We would strongly agree with this, because it is essential to begin to place the responsibility on those who own these properties.

The ultimate goal would be to phase out all subsidies and to rate all properties based on their true risks. An equally important alternative that must be pursued to help those for whom actuarial rates would be a significant hardship, is to provide substantial and sustained support through hazard mitigation grants to reduce their costs and costs of insurance. We also believe that hazard mitigation and strengthening of NFIP standards should be cornerstones of restoring financial integrity.

Overall, funding for hazard mitigation has dropped in recent years and needs to be increased. The grants formula for the Hazard Mitigation Grants Program should be restored to the 15 percent level that it was at prior to 2003, and it should be applied immediately to help Gulf Coast communities.

We have suggested in our written testimony a number of improvements in NFIP standards that would help ensure that we are not just building up more risk over time that is vulnerable to major storms. We would urge that FEMA be charged with identifying the places where it is simply too risky or unwise to continue to make flood insurance available.

It has also been suggested that the mandatory purchase requirement be extended to areas behind levees and below dams to insure for the associated residual risk in the event of structural failures. We would strongly support this change in light of numerous recent examples where many flooded residents found themselves with major losses and without insurance.

The accurate mapping of flood hazards is fundamental to the NFIP and for basic community planning. We greatly appreciate the continued support of the Administration and Congress for the map modernization program, but additional steps are needed. We strongly urge the Committee's supervisor for S. 2005, recently introduced by Senator Reed, that would expand mapping to the 500-year floodplain and for related flood hazards as well as provide funding that will be absolutely necessary to have the quality mapping that is needed in the future.

Again, Mr. Chairman and Members of the Committee, we applaud your work to reform the NFIP. The program has fallen short of its initial promises and currently finds itself in extremely serious financial trouble. The program has been successful in many ways to reduce the adverse impacts of flooding on many of the Nation's communities, yet it has overall failed to put insurance on an actuarial footing, to accurately assess flood risks, to adequately communicate those risks to the public, and failed to adequately discourage building and rebuilding in high and substantial risk areas.

For 38 years, it has continued to highly subsidize many of the policies it sells, thus skewing market signals as to the risks involved with certain floodplains locations and in some cases serving as an inducement to developing high risk areas rather than the opposite. Perversely, this has also had a substantial adverse effect on many sensitive and critical ecosystems that support a large portion of the Nation's wildlife, with the result sometimes being intensive urbanization and fill immediately along the Nation's rivers, streams, coastlines, estuaries, and barrier islands with heightened flood risks.

We are ready to work with the Committee to make needed improvements. Thank you for asking me to provide the views of the Federation. I would be happy to respond to any questions you have.

Chairman SHELBY. Thank you.

I am going to recognize Senator Santorum for any comments he wants to make on Ms. Lowrie.

STATEMENT OF SENATOR RICK SANTORUM

Senator SANTORUM. Thank you. I appreciate the indulgence of the Chairman. I just got back from the National Prayer Breakfast, and I guess Bono decided he was going to speak a little longer than everybody anticipated.

Let me thank you, Mr. Chairman, and I just wanted to come by and thank you for holding this hearing. This is a very important topic, one that we have experienced in Pennsylvania the inadequacies of this program and the problems with it. So, I am very pleased that you are doing so. I wanted to come by and welcome to the Committee Regina Lowrie, and I thank her for the terrific work that she has done in Pennsylvania and nationally now with the Mortgage Bankers Association. She has been a great leader in making homeownership more affordable due to the tremendous work of the mortgage bankers, and I welcome her here and thank her for her testimony.

Ms. LOWRIE. Thank you, Senator.

Chairman SHELBY. Ms. Lowrie, you proceed.

STATEMENT OF REGINA M. LOWRIE
CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

Ms. LOWRIE. Thank you.

Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. Thank you for inviting the Mortgage Bankers Association to testify here today. My name is Regina Lowrie, and I am President and founder of Gateway Funding Diversified Mortgage Services, located in Horsham, Pennsylvania, and I am the 2006 Chairman of the Mortgage Bankers Association.

The hurricanes of 2005, Hurricanes Katrina, Rita, and Wilma, resulted in unprecedented damage and destruction to homes and businesses. The flood insurance program has been an important part of the recovery throughout the entire Gulf Coast region. NFIP testified last week that 75,000 claims had been paid. Yet, NFIP also testified that they will need an additional $5.6 billion in borrowing authority to continue paying flood insurance claims from these storms.

First and foremost today, MBA believes it is crucial that Congress move quickly to increase the borrowing authority in order for the program to continue to meet its obligations to the current policy holders and claimants in the affected Gulf region.

The cost of the flood insurance program to the Treasury in the wake of these disasters has raised some important issues about the long-term viability of the program. MBA believes the program is vital to homeowners to help maintain value in their property and facilitate affordability.

The Committee asked MBA to discuss some of the ideas that have recently been raised to maintain the solvency of the National Flood Insurance Program. As background, even before the statutory mandatory requirement, lenders often required flood insurance to protect their collateral interests. With the passage of the Flood Disaster Protection Act of 1973, however, it became unlawful to make, increase, extend, or renew a loan secured by a structure in a special flood hazard area without flood insurance coverage for the life of that loan.

Without a reliable and uninterrupted source of flood insurance, we believe that mortgage credit would at best be more expensive or at worst unavailable in many markets. Although there are private providers of flood insurance, MBA estimates that 90 percent of all flood policies are written through NFIP. The mortgage industry wants to ensure the continued viability of the National Flood Insurance Program.

One of the ideas to increase participation in the flood insurance program is to expand the definition of a special flood hazard area to the 500-year floodplain map. At this time, without further study, MBA cannot support this expansion of coverage.

The burden of enforcing compliance with flood insurance requirements falls squarely on the mortgage industry. The 1973 Act, for the first time, restricted federally insured depository institutions from making loans in a special flood hazard area without flood insurance. The National Flood Insurance Reform Act of 1994 expanded that mandatory purchase requirement to loans purchased by Fannie Mae and Freddie Mac. The Act also reaffirmed the lenders' obligation to keep the policy that was obtained at origination in full force for the life of the loan through the use of lender-placed insurance if it was necessary.

We were very concerned, however, with remarks made by the NFIP last week before this very Committee. In response to questioning, the Acting Director said he believed the level of noncompliance with the mandatory purchase requirement was between 40 and 60 percent. Since he did not state or did not recall where he had seen that data, I would like to take this opportunity to comment on lender compliance.

As an industry, mortgage companies execute the flood insurance obligations consistently, in good faith, and with few errors. In fact, a March 2005 study produced for FEMA by the American Institutes for Research shows significant compliance with the law. The bank regulators had similar findings.

The flood insurance statute is a complicated law with a magnitude of requirements. Our written testimony goes into detail regarding the significant procedures to ensure compliance with these and other statutory obligations that our members have instituted.

Mr. Chairman, MBA appreciates the opportunity to testify before you today. We stand ready to work with you and the rest of your Committee to find ways to make the program work better for policy holders, stakeholders, and the Federal Government. Thank you.

Chairman SHELBY. Mr. Hunter.

Senator SARBANES. Mr. Chairman.

Chairman SHELBY. Yes, Senator Sarbanes.

Senator SARBANES. Before, can I just ask for a quick definition?

Chairman SHELBY. Sure.

Senator SARBANES. What is your definition of significant compliance? What percentage figure would you use?

Ms. LOWRIE. In a recent interview with a Fannie Mae representative who had done an audit of their seller servicers and the compliance, out of an entire portfolio of seller servicers' loans, there were six loans of noncompliance. Overall for the industry, we think that number is close to 95 percent, Senator.

Senator SARBANES. So you use a 95 percent figure rather than a 40 to 60 percent figure.

Ms. LOWRIE. No, 95 percent compliant.

Senator SARBANES. The agency, in effect, would have somewhere between 40 and 60 percent compliant. They said 40 to 60 percent noncompliant, but, I mean, you just turn that around; is that right?

Ms. LOWRIE. Yes; they said 40 to 60 percent, right.

Chairman SHELBY. Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

Mr. HUNTER. Good morning, Mr. Chairman, Members of the Committee.

I love the National Flood Insurance Program. As Senator Sarbanes indicated, I poured a lot of my own life into it in the first 10 years, first as Chief Actuary, so I can answer some of your actuarial questions, hopefully, and as the Administrator.

If it worked as Congress intended, it would have blessed the Nation by now, and we would be seeing a lot less flooding, not more. It would have made sure that new building was wise in the flood hazard areas. It would have eliminated building in very high flood hazard areas, and it would have covered all those by now exposed to flood hazard.

I say this because I have to sadly raise the question today whether this program should be continued. If it is not fixed, I do not think it should. If the program encourages unwise construction in floodplains, it is a danger to the Nation rather than a blessing. If the program lures people unexpectedly into floodplains, if it subsidizes construction in unsafe places, if it cannot deal with communities flaunting the program's requirements, if it falsely assures people that they are in low risk areas when they are not, it must be reformed, or it must end, because it will encourage, as you say, people to come in to high risk areas and build.

I also love New Orleans. That is where I was born, and I have been a very strong advocate over the years for the poor, as you probably know. However, you cannot change the flood program to allow unwise reconstruction or new construction in New Orleans. We hear that the city, from several sources, is allowing people with an excess of 50 percent damage to rebuild without elevating their homes under a program that has allowed 90 percent of the appeals to be reversed, even though the damage is a lot more than 50 percent, according to people I have talked to.

It is not doing the poor a favor to let them build back the same way their house was before Katrina. It is just setting them up for the next flood, for another bout with grief and destruction. FEMA cannot allow sympathy to stop it from doing what is required by Congress and by their regulations.

I support helping residents with direct aid in some fashion, whether it is the Baker approach or whatever. I think that is needed. And that needs to be done particularly for those who do not have flood insurance, but we cannot afford to allow rebuilding in high risk areas without proper elevations. If you do not force the elevations to be done properly, how do you, in the next flood, force them to do it if a flood in Ohio happens or Rhode Island, God forbid, or something? So FEMA should be moving firmly to assure that this is stopped.

You should also terminate the program if the maps are not made current. This is really a disgrace. When I was administrator of the program, we had the goal of updating the maps every 3 to 5 years, and even then, we were worried about should we add a freeboard, because we know that development pushes the elevations up.

Consider Hancock County, Mississippi. There are 76 different maps covering most of that county on FEMA's web page. Those maps, called Hurricane Katrina surge, inundation, and advisory base elevation maps are really a smoking gun on how FEMA's inaction has contributed to the devastation people felt from Katrina. The maps show that the antiquated 100-year flood levels are out of date, and on average, 12 feet too low. The maps that are currently in force in that county on average are 12 feet below what they now say the 100-year risk is.

So somebody who built according to the FEMA requirements and thought they were safe were way, way underwater when that happened, plus a lot of people who were outside the flood zone, because let us say in one place I was looking at, the current map is 9 feet, and the new map would be somewhere between 20 and 30, the size of the flood zone would be much larger, so a lot of these people who do not have flood insurance would have had flood insurance had the map been properly drawn, because when they got their mortgages, they would have been required to get it.

These are not unique to Mississippi. These old maps exist everywhere; I mean, not every map is 20 years old like that, but the maps are old, and that is bad. As a result, people are building what they think are safe homes, and to varying degrees, they are not.

Actuarial rates are predicated on these maps, so if the map elevations are too low, the rates are too low. I am getting a very cheap rate if I build at 9 feet when I should have built at 20. In effect, it is a hidden taxpayer subsidy of unwise construction.

Further, large areas outside the area, as I said, were actually in the high risk area, and people did not have insurance and thought they were safe, and many of them have called us and said we talked to our agents; they said you are outside the area, and do not worry about it. So they really were in the area, and FEMA is in large measure at fault for that, for them not having insurance. If the maps are not quickly brought up-to-date and kept up-to-date, the program should be terminated to end the taxpayer subsidy.

Actuarially, the NFIP collects too little money to cover losses over the long haul. When I talk about actuarial soundness, Senator Sarbanes, actuarial soundness typically means prospective. Rates should be accurate for covering the future risk. You do not go back and recoup, at least actuarially, so this loss that you have currently is beyond actuarial soundness if you are going to try to recoup it. Actuarial soundness is a prospective thing. The current estimates are that there is a $1.3 billion shortfall actuarially on a $2 billion premium base, so that is about a 65 percent shortfall, but that would not recoup what you are about to pay out and have already authorized a lot of.

Katrina is only one example of the kind of shortfall, though, because the NFIP now only covers enough to pay for the relatively normal flooding of a year. Katrina obviously is a lot bigger than that, and now, you are learning it. But even bigger floods than Katrina are possible and in the long-term certain: A Category 5 storm at Miami Beach or Long Island are just examples where you could have a lot bigger claims than that.

Let me just say simply, for the program to be actuarially sound, you have to charge actuarial rates, and that has to be done over the long haul. There are other steps, though, that can save money, like eliminating the excessive write-your-own expenses, the $1 billion of the $2 billion problem, and also making sure mitigation is enforced. And these are necessary steps toward bringing it toward soundness, but they are not sufficient. You have to make the rates actuarially sound ultimately.

And obviously, I, for the poor, for the lower-income people, you have to have some type of a transition program over time as the house is sold or something. For second homes and very valuable homes, I think you can move more quickly if not immediately.

The last time I testified, I gave you several ideas. I would just want to reiterate a couple of those, but I do reiterate all of them. You have that in the record. I believe you should move to a 500-year requirement for both mitigation and purchase requirement. You should eliminate the subsidy on high value structures immediately, also on second homes and on homes with previous serious flood damage and particularly repetitive flood damage. Mid-value structures could have their subsidies phased out in the intermediate term and low-value structures when they are sold.

Homes that would be in floodplains except for flood works such as levees and dams that can fail should be required to buy the coverage. That does not mean that they should not pay a lower rate to take into account that it is safer than it would be without those structures, but it still means they should buy it, because we know dams and levees fail. It happens all the time.

Consider giving private insurers skin in the game. I mentioned that last time, at least for the actuarial part of the business. As you move toward actuarial rates, there is no reason why they cannot take over more of the action. 2005 is shaping up to be their third highest profit year in history. 2004 was their largest profit year in history even with all these hurricanes and storms.

I mentioned you should deal with the excessive expenses and the write-your-own program. In order to obtain greater market penetration, you must find ways to make the purchase requirement work. You can find out exactly how much shortfall there is, but it seems to me that from talking to victims, people who used to have flood insurance, a lot of times, the bank did not keep tracking them and keep them, although some banks do, some do not.

But worse, State-regulated banks and State-regulated insurance companies do not have to require flood insurance at all, and you need to move to get those entities required. And GAO must be tasked with seeing if communities are really meeting their burdens of mitigation.

Mr. Chairman, I never thought I would utter the words consider terminating the flood insurance program, really. It is a beautifully conceived program Congress created, but it has suffered from poor administration, and it is really a negative rather than a positive impact in the floodplains today, and I urge you to act to fix that.

Chairman SHELBY. Mr. Pressly.

STATEMENT OF DAVID PRESSLY
NATIONAL ASSOCIATION OF HOMEBUILDERS

Mr. PRESSLY. Chairman Shelby, Ranking Member Sarbanes, Members of the Committee, my name is David Pressly, and I am a homebuilder from Statesville, North Carolina, and the President of the National Association of Homebuilders, and I thank you for the opportunity to testify on behalf of the NAHB regarding reform of the National Flood Insurance Program.

The Federal Emergency Management Agency's National Flood Insurance Program plays a critical role in directing the land use of flood-prone areas and managing the risk of flooding for residential properties. The availability and the affordability of flood insurance gives home buyers and homeowners the opportunity to live in the home of their choice and in a location of their choice even if that home may lie in a floodplain.

The homebuilding industry depends upon the NFIP to be annually predictable, universally available, and indeed, fiscally viable. Unfortunately, the devastation brought about by the Hurricanes Katrina, Rita, and Wilma has severely taxed and indeed threatened the solvency of the NFIP. While these losses are severe, they are currently unprecedented in the history of the NFIP and therefore not a reflection of a fundamentally broken program.

Therefore, while NAHB supports reforms aimed at supporting the long-term financial stability of the NFIP, any resulting reforms must not be an overreaction to unusual circumstances. And indeed, this reform should take the form of a thoughtful, deliberative, and reasonable solution.

As part of a coalition of interested trade groups, NAHB has forwarded a list of reforms designed to allow FEMA and the NFIP to better adapt to changes, to risk, to inflation, and indeed, to the marketplace. These reforms include, first, providing FEMA with the authority to allow for slightly higher annual premium increases; second, to increase coverage limits to better reflect today's home values; third, to create a deluxe or enhanced flood insurance option, and certainly, increasing the minimum deductible paid on claims.

Now, while these reforms I just mentioned can be enacted relatively quickly, other reforms require additional study. One option that has been widely considered is the mandatory purchase of flood insurance for homes located behind flood control structures. This strategy would obviously increase the number of policyholders and thereby the influx of premiums.

However, it is much more complicated. The NFIP and its implementing provisions were created to balance the needs of growing communities with the need for reasonable protection of life and property. Therefore, FEMA should first demonstrate that the impacts stemming from any reforms will be more than offset by the increased premiums, required protections and, indeed, administrative burdens.

A key component of such study is the need for accurate flood insurance rate maps. NAHB applauds the strong leadership of this Committee to direct FEMA to modernize its maps.

While changes to the NFIP's mandatory flood insurance purchase requirements represents one set of issues, a change from the 100-year to a 500-year standard would present an entirely different set of issues. Changes to the 100-year flood plan have been considered in recent years, but even experts have failed to reach consensus on the issue. What has emerged, however, is a recognition of the tremendous implications that changing the standard floodplain would have on homebuilders, homebuyers, on communities and local government and indeed the Federal Government itself.

Finally, I would like to talk to you about one of the basic tenets of the NFIP, and that is the residential design standards. Now, currently, FEMA requires every home that is built in the 100-year floodplain to be elevated above the base flood elevation. While this requirement may be appropriate for the 100-year floodplain, NAHB strongly opposes to expanding these requirements to any new classes of structure such as those located behind flood protection structures or those in any newly expanded NFIP floodplains.

Additional construction requirements would increase the costs of a new home construction and impact housing affordability. For example, on the Gulf Coast, elevating new structures could add, on average, $30,000 to the cost of a new home. It is easy to see the tremendous impact that such reforms would have. NAHB urges Congress to soften the impact of any programmatic changes to the NFIP by ensuring that construction requirements remain tied to the current 1 percent standard.

Mr. Chairman, I thank you for the opportunity to share our views with you and your Committee.

Chairman SHELBY. Mr. Gessing.

STATEMENT OF PAUL J. GESSING
DIRECTOR OF GOVERNMENT AFFAIRS,
NATIONAL TAXPAYERS UNION

Mr. GESSING. Chairman Shelby, Ranking Member Sarbanes, and distinguished Members of the Committee, thank you for holding these important hearings today. My name is Paul Gessing. I am Director of Government Affairs with the National Taxpayers Union, America's oldest and largest grassroots taxpayer lobbying organization, with 350,000 members nationwide.

I would also note that my organization works closely with the group Taxpayers for Common Sense, and I am here to testify not only on behalf of my own organization but also on behalf of Taxpayers for Common Sense and their Vice President of Programs, Steve Ellis, who could not attend today.

I come here today to offer testimony regarding what we believe are some rather significant problems with the National Flood Insurance Program as they relate to taxpayers to illustrate to the Committee why many of these taxpayer concerns also have a direct impact on those living in flood-prone areas, and last to outline the need for bold steps on the part of Congress to ensure that the next major hurricane or flood inflicts less of a toll, in the forms of human suffering and lost economic productivity and taxpayer money.

Although the original intent of the existing Federal flood insurance program was to mitigate many of these problems, it has not done so, and as such, must be considered a failure. The recent spate of hurricanes may have been unique in recent history for their intensity and frequency, but they are perfectly normal in costing Federal taxpayers billions of dollars.

Worse, there is wide agreement in the scientific community that the trend of increasing intensity and numbers of hurricanes will continue for several years. Even before these hurricanes, the NFIP had repeatedly relied on the U.S. Treasury to supplement its premium revenues. Last week, several of those testifying on NFIP stated that from 1986 through 2004, NFIP was self supporting. I would argue that those statements are in error. First of all, how can you bookend a program like that? Starting in 1986, the program shifted from direct appropriations to the current system, which the program borrows from the Treasury and repays its debt with interest. By the way, it must be noted that NFIP was forgiven well over $1 billion in debt at that time.

Then, over the 18-year period in question, NFIP borrowed when it needed to and repaid with interest, but the simple fact that it was able to borrow shows that it is not self-supporting or actuarially sound. There is no catastrophic reserve, because the program has the taxpayers to fall back on.

In the aftermath of the 2005 hurricane season, the program will be forced to borrow an astonishing $24 billion the Treasury. It is time to face facts: With premium payments yielding $2 billion per year and flooding likely to continue, even if not at the level we have seen in recent years, there is little likelihood of taxpayers ever recouping much of the $24 billion they are now owed.

Thus, Mr. Chairman, as you said in your opening remarks, the NFIP is bankrupt. As taxpayer advocates, what we must do now is work to ensure that the NFIP no longer serves as a fiscal black hole. Prior to the NFIP's existence, insurance coverage for flood losses was not provided by any private insurance carriers. Insurance losses stemming from flood damage were largely the responsibility of the property owner, although the consequences were sometimes mitigated through provisions for disaster aid.

Today, the owners of property in floodplains sometimes receive disaster aid and payments for insured losses, which in many ways negates the original intent of the NFIP, that being to encourage property owners to pay some of the up front costs of expected disasters rather than forcing taxpayers to foot the bill after the fact. These policy decisions have contributed to an escalation in losses stemming from the floods in recent years both in terms of property and life.

Also, though this is not of primary importance to taxpayers, I must point out that subsidizing insurance in high -risk areas takes a significant environmental toll. Coastal areas are often among the most ecologically sensitive and diverse. Thus, it is disconcerting to know that while they spend untold billions of dollars annually on an array of environmental mitigation efforts and often see their lands' usefulness decline under Federal mandates also for the purpose of environmental mitigation, taxpayers are then forced to pay once again, this time for a program that actually encourages the destruction of environmentally sensitive areas.

The final area of concern taxpayers have about this program are those involving fairness and moral hazard. Specifically, I would like to bring to your attention and submit for the record a story conducted by John Stossel of ABC News. In 2003, in the wake of Hurricane Isabel, Mr. Stossel did a story called Taxpayers Get Soaked by Government's Flood Insurance. In this piece, Stossel recounted his own personal experience of purchasing beachfront property on Long Island, New York, and constructing a house there in 1980.

Stossel noted among other things that the most he ever paid was a few hundred dollars for insurance that actuaries say should realistically have been priced at thousands of dollars.

John Stossel is not the only well-heeled individual taking advantage of the taxpayer-subsidized flood insurance. According to a 2000 report by the *Philadelphia Inquirer,* 6 of 10 NFIP-insured properties are in beach towns, and since the program does not differentiate between primary residences and vacation homes, the program's mission could be said to include ensuring that wealthy Americans are protected from floods by the full faith and credit of the U.S. taxpayer.

Asking taxpayers to spend billions annually on Government programs and revenue transfers designed with the purpose of assisting poor and lower-income Americans is one thing, but asking them to spend additional billions on the NFIP, which is more of a taxpayer financed safety net for millionaires, is yet another. It is, after all, predominantly wealthy people with enough disposable income to own beachfront property who choose to live or have a second home in risky areas.

Then, because it is priced far below market value, flood insurance proves even more attractive to wealthy homeowners who know a good deal when they see it. Thus, the wealthy snap up coverage, while the poor are often left unprotected when disaster strikes.

To continue with Stossel's story, as it turns out, despite beach replenishment efforts by the Army Corps of Engineers, again, taxpayer-financed, his house was washed away completely in a storm that he described as fairly ordinary. Of course, the NFIP paid for the house, the first $250,000 of which is insured under the Federal program, and its contents, insured to $100,000, and there were only minimum restrictions on rebuilding on the same piece of land. Worse, he pays the same price for insurance the day after the storm as the day before.

Quite simply, this is a ridiculous policy. We have a clear result. The location is at great risk for loss, and yet, we do not restrict reconstruction, and we charge the same rate. I certainly cannot think of anyone who would run a business that way; no wonder we are in a hole.

It is said that the road to hell is paved with good intentions, and like all Government programs, the NFIP was created with good intentions in mind. To this day, many of the program's supporters believe that the NFIP actually saves taxpayer dollars, because with insurance, taxpayers receive at least some compensation before the disaster strikes, whereas they are never compensated for disaster relief.

Even had it been well-planned and executed effectively, the Federal flood insurance program has had other unintended consequences. Rather than simply compensating homeowners for losses, the cheap insurance has actually encouraged more people to build in flood-prone areas. Last week, David Maurstad testified that NFIP insured more than $800 million in assets on 4.8 million policies. Back in fiscal year 2002, that number was only $644 million on 4.5 million policies. That is a 24 percent increase in insured assets on just more than a 6.5 percent increase in policies.

Sure, the housing sector has been strong Nationwide, but as Senator Reed pointed out in his opening remarks, there is a building boom going on on our Nation's shorelines, as increasing numbers of wealthy people build their castles on the sand. It is self evident that this boom is subsidized at taxpayer expense.

So what do we do now? As in a 12-step program, the first part of solving a problem is recognizing that you do, in fact, have one. The recent spate of hurricanes has only exposed what experts and taxpayers have known for a long time: Federal meddling in the marketplace inevitably results in subsidies for some and significant costs for all taxpayers. Congress must act now to restore some semblance of a marketplace for flood insurance that contains adequate taxpayer protections, or it must be willing to abandon the program entirely, leaving the responsibility of finding adequate insurance in the hands of individuals and insurance companies.

If nothing else, at a bare minimum, Congress must consider taking action to address the subsidies inherent in the 25 percent of NFIP's covered properties that predate flood insurance rating maps.

NFIP has been in effect for nearly 40 years. That is far longer than even the longest mortgage. Surely, it is time to stop paying massive subsidies to the shrinking group of unaware, pre-FIRM homeowners. Other reform measures lawmakers might consider would be collecting actuarially sound rates to finance expected annual payments as well as catastrophic reserve, increasing program participation through greater enforcement and by expanding the floodplain areas requiring coverage, and increasing the use of disaster relief funds to mitigate future damage by making communities more flood and disaster resistant through flood proofing, elevating, and relocating repeatedly damaged properties.

Unfortunately, the fact that for all these years, Congress has been unwilling to reform the NFIP in ways that adequately protect taxpayers, eliminate subsidies, and make the program actuarially sound may serve as a clear sign that the best way to address the program's shortcomings is to eliminate it entirely.

Federal involvement in the provision of flood insurance has been on the whole counterproductive. Rather than discouraging development in flood-prone areas, it encourages development. Rather than protecting Americans from nature's ravages, it puts them in harm's way, and rather than saving taxpayers money, it has resulted in additional expenditures and subsidies on a massive scale. That sounds like a failure to most reasonable people.

If, after the marketplace is freed of Federal subsidies that have kept for-profit firms out of the business, private companies remain skeptical of the profitability of providing flood insurance, all is still not lost. The reaction may be yet another tool to reinforce the message that living in flood prone areas is risky and that most people should be forced to bear the loss of such unwise moves.

Of course, it is also quite possible that some entrepreneurial company might figure out a way to reduce its risks enough to make a profit, thus creating a performance flood insurance marketplace more viable than it has been in the past.

I must note that although NTU and the Consumer Federation of America rarely agree on much, and we certainly do not have the same philosophical approach to many issues, Bob Hunter's comments at the Committee's October hearing on flood insurance were spot on when he suggested that the insurance industry might be better able to engage in the flood insurance market than they have been in the past due to the development of improved mapping technologies.

Had the NFIP not been created in 1968, and we were discussing the possible creation of such a program today in the wake of recent hurricanes and flooding, I do not think anyone would choose to replicate the existing system. Thus, if I were sitting before you today to testify on whether or not to create the NFIP, and if so, what it should look like, I would tell you that at times during which we, as a Nation, are presented with difficult policy decisions, we as an organization advocate looking to the Constitution and the Founding Fathers for guidance.

Thus, we believe that leaving flood insurance policymaking up to the States would allow for the most creative and responsible outcomes possible. State and local officials, aware of the unique needs and challenges of their own locations, could design the best solutions for their particular environments.

Although this hearing is strictly about the Federal flood insurance program, as a brief aside, I would like to point out that NTU and our members believe that rather than centralizing the job of flood prevention in one Federal body that receives its funding and marching orders from Washington, States and localities should be likewise empowered to take charge of flood prevention efforts whenever possible.

The emphasis on local control does not mean there is no Federal role, especially in disaster relief. But as we saw in New Orleans, when the responsibilities of Federal, State, and local governments overlap, too often, there are also massive cracks in the system through which responsibilities tend to fall. If Congress were to take a close look at the interactions among the various flood prevention insurance and relief tools, we believe it would discover that restoring the primary responsibility for natural disaster planning and responses to the States with Federal agencies in a supporting role would leave all of us, citizens, taxpayers, and policymakers alike, better off.

Thank you for allowing me to testify and for your work on this topic.

Chairman SHELBY. Mr. John.

STATEMENT OF DAVID C. JOHN
SENIOR RESEARCH FELLOW,
THOMAS A. ROE INSTITUTE FOR ECONOMIC POLICY STUDIES,
THE HERITAGE FOUNDATION

Mr. JOHN. Thank you. Mr. Chairman, Members of the Committee, thank you for the opportunity to testify this morning. I am David John. I am a Senior Research Fellow at the Heritage Foundation.

The catastrophic losses that the National Flood Insurance Program faces in the wake of last year's hurricane season proves that it is time for Congress to fix the program once and for all. According to David Maurstad last week, the Acting Insurance Administrator of FEMA, claims due to Katrina and Rita could exceed $22 billion, about one and a half times the $15 billion that NFIP paid out in claims between its creation in 1968 and 2004.

Congress' reaction has been very interesting so far. In September, NFIP's authority to borrow from Treasury was raised from $1.5 billion to $3.5 billion. November saw a further increase to $18.5 billion. And last week, Mr. Maurstad told the Committee that NFIP will need about another $6.5 billion more just to cover claims and expenses through the end of fiscal year 2006.

Interestingly, it appears from his testimony that $670 million of the roughly $25 billion that NFIP expects to borrow from the Treasury will go back to that agency, Treasury, that is, in the form of interest payments. Now, in theory, NFIP will repay these loans from its premium income, but if interest at $670 million a year eats up roughly 35 percent of its annual income of roughly $2 billion, the only way that repayment is going to be possible would be if premium income is greatly increased and average claims remain at the pre-Katrina level.

Now, since NFIP is expected to repay the loans, its administrative expenses and average year losses from that $2 billion, realistically, the only way to get these loans off of NFIP's books will be for Congress to eventually forgive them. Unfortunately, the demands on the flood insurance program are not likely to decline. While flood losses from a single storm like Hurricane Katrina may be exceptional, as has already been noted, scientists expect hurricane activity to continue to build in coming years. As millions of Americans continue to relocate to flood prone areas and property values in those areas continue to rise, NFIP can expect to face much higher levels of annual claims than it has in the past.

Another challenge to the program's finances would develop if Congress increases the level of flood insurance coverage available on single structures and their contents. Such an increase would, in fairness, reflect rising property values, but it is questionable if premium income on the increased insurance levels would cover the higher losses.

The only way to avoid constant deficits and increased borrowing is to reform the program. The current request for additional borrowing authority is an excellent opportunity to make substantial changes that will reduce the likelihood of continued NFIP bailouts. There are four steps that we think would be ways to deal with this: Step one, eliminate the current subsidy on older structures and require the coverage for replacement value of the property.

Today's NFIP subsidizes roughly a quarter of the structures that it insures. That leaves roughly 24 percent receiving some kind of a subsidized level. We have already heard it estimated that that is roughly $1.3 billion a year. NFIP should eliminate the subsidy for older structures, because its continued existence is a danger to the program. In order to minimize the impact on home and business owners, the subsidy could be phased out over several years. To some extent, the higher premiums will make it more attractive to replace older structures that are prone to higher flood losses with new buildings that incorporate architectural features that would minimize such damage.

In addition, many NFIP policies only cover the remaining balance of a structure's mortgage and not the cost of actually replacing it, subject to, of course, the $250,000 ceiling on coverage. This protects the lender, but it can leave homeowners with a ruined property that they cannot afford to rebuild. Flood insurance should also cover the cost of replacing the structure, again, subject to the $250,000 ceiling, rather than just the cost of repaying its mortgage. Although this would increase premiums, insuring to replacement value will make it more likely that homes and businesses will be able to rebuild rather than to relocate.

Step two, require flood insurance where storm surges are possible, including areas behind a levee or other flood control measure. Currently as we have already heard, flood insurance is only required where there is a 1 percent chance of a flood and not in low-lying area where surges are likely following storms. A significant number of the property owners affected by Hurricane Katrina suffered water damage despite the fact that their structures were well outside of the 100-year floodplain, where flood insurance is required.

Flood insurance should be required in all areas where a flood or storm surge is likely if a weather event reaches catastrophic levels. Especially with serious hurricanes more likely to occur in the future, it makes little sense to continue to leave structures at risk of storm surge damage or near levees that could fail outside the system. NFIP should also assess the possibility, probability, we have now learned, that flood control measures in an area are likely to fail or are inadequate when determining premiums. In addition to making actuarial sense, this step would help to better inform homeowners of the risk of flood damage that they actually face.

Step three, strengthen the mitigation programs to reduce repeat losses. You have already heard this morning some rather alarming statistics about the impact of repeat losses on a program. Congress should pressure NFIP to step up mitigation, and that includes improving its maps, of course, by setting explicit goals for the agencies and establishing regular reports by an outside agency on its progress that are examined at regular oversight hearings.

In most cases, retrofitting structures to reduce the flood damage, as we have heard, will save NFIP the cost of expensive repairs and the structure's owner the disruption caused by flood damage.

Last but not least, step four, assess higher premiums for vacation homes and second homes. Currently, NFIP charges the same rates for both vacation homes and owner-occupied structures. However, the number of homes built on coastal barrier islands continued to grow very rapidly, with a significant proportion of these homes being expensive vacation homes that are rented out for most of the year.

One way to raise NFIP's income would be to charge owners of these homes higher premiums. Initially, we would suggest second or vacation homes could be charged 15 to 20 percent more than owner occupied structures, but over time, this surcharge could be increased even higher if it was so desirable.

The higher cost would be largely borne by increased rental fees, while the additional money could be used for a variety of purposes ranging from repaying the loans to the Treasury that you are authorizing this year, financing additional mitigation efforts, or even slightly subsidizing the flood insurance premiums of lower income homeowners.

Especially in coastal areas, artificially low flood insurance premiums are subsidies that encourage people to live where natural disasters are more likely to occur. While people should be allowed to live where they please, they should also bear the risk that their choice may subject them to storms, floods, tornadoes, or other natural disasters.

Hurricane Katrina caused what will eventually be recognized as a massive bailout of the flood insurance program, and current weather and population trends make future bailouts likely. Rather than waiting for the next time there is a storm and the next time you have to raise NFIP's borrowing level, Congress should make NFIP actuarially sound now.

Thank you.

Chairman SHELBY. Ms. Pogue.

STATEMENT OF PAMELA MAYER POGUE, CFM, CHAIR, ASSOCIATION OF STATE FLOODPLAIN MANAGERS

Ms. POGUE. Mr. Chairman, Ranking Member Sarbanes, Committee Members, and Senator Reed, on behalf of the Association of State Floodplain Managers, I want to thank you for allowing us to be part of this very important discussion about ways to reform the National Flood Insurance Program.

My name is Pam Pogue, and I am here as the Chair of the Association of State Floodplain Managers. The association and its 22 chapters represent over 9,000 State and local officials and other professionals who are engaged in all aspects of floodplain management and hazard mitigation. Many of our members are presently working with communities impacted by Hurricanes Katrina and Rita or work with organizations that are assisting those communities in rebuilding.

I am also the State National Flood Insurance Program Manager and Earthquake and Hurricane Program Manager for the State of Rhode Island and a native Floridian. I was here for last week's hearing and enjoyed listening to the discussion, commentary, questions, and concerns, and I am very pleased to be here today to participate in this hearing. We want to express our appreciation to you for this thoughtful examination of the National Flood Insurance Program and ways to improve this program.

What a year. As we all know, it has been a real challenge for the NFIP. This past season of natural disasters has highlighted problems that needed to be addressed within the existing framework and has called attention to the need for creative solutions for the long-term solvency of this program.

Chairman Shelby, Senator Sarbanes, and others highlighted the problems presented by the totally unprecedented anticipated payouts of $24 billion. After all, there has only been $15 billion worth of claims paid out in the whole history of the program.

However, I would like to point out that since the inception of the National Flood Insurance Program 38 years ago, there has been much success. I ask you to keep in mind that there is much more to the NFIP than the provision of flood insurance. Bearing in mind that the NFIP is a quid pro quo program, the availability of flood insurance is contingent upon flood loss reduction measures embodied in State and local floodplain management regulations. These measures guide development in high risk flood hazard areas, both riverine and coastal areas, in order to reduce flood losses.

As we have witnessed in the last two hurricane seasons, there are areas where the program needs to grow and mature. When the NFIP was created by Congress in 1968, there was little data available about what the size of a 100-year floodplain and the number of properties in it. It was a bold action by Congress to establish the insurance program to make citizens more nearly whole after a disaster than they would be with disaster relief, to make sure that citizens living in at-risk locations bore some portion of the risk through paying premiums, to save taxpayers money in disaster relief and to reduce flood losses over time through floodplain management.

For nearly 20 years, the NFIP has afforded protection to policy holders, guided development out of harm's way, and repaid any Treasury borrowing with interest. Although the season of Katrina, Rita, and Wilma has been a wakeup call, let us not forget how effectively the NFIP has done its job for many years.

Now, we see that the risk extends beyond the 100-year floodplain and includes the 500-year floodplain as well as residual risk areas behind levees and below dams. This is particularly true because of the predictions of more frequent and intense storms. Once again, Congress faces the questions associated with providing protection for those in at-risk areas.

The answers will probably lie in a combination of reducing the subsidies in the NFIP, expanding the areas covered, improving investment in mitigation, and exploring creative solutions to those catastrophic losses that go well-beyond the average loss year.

I will briefly list some of the mitigation ideas, program expansion, subsidy reduction recommendations that the ASFPM has. I would also like to suggest that the Committee request a study of the ways to accommodate those catastrophic loss years, whether through a catastrophic loss fund, a reinsurance arrangement, or some other technique.

I mention only a few examples of these reforms to the NFIP as a means of strengthening the program. Obviously, it is in much greater detail in our submitted testimony. In terms of risk reduction, enforce the use of advisory maps. Advisory maps have been produced for much of the Gulf Coast area impacted by the hurricanes. We commend FEMA for working to tie the use of those maps showing the true risk to the receipt of Federal assistance.

FEMA's Acting Director of Mitigation and Insurance, David Maurstad, testified here last week that about 30 percent of the communities in the region have adopted these new elevations, but that leaves 70 percent that have not. We urge the Committee to support FEMA's efforts. We urge other Federal agencies to require the use of these advisory flood maps. Insufficient coordination among Federal agencies leads to sometimes undercutting other agencies' programs and creating confusion for local officials. We urge a mechanism to ensure the adherence to Executive Order 11988, which calls for interagency coordination for disaster mitigation and floodplain management.

Also provide for additional and more flexible increased cost of compliance coverage, or ICC. An ICC surcharge of up to $75 is applied to each policy premium to pay for bringing these substantially damaged properties up to code and floodplain management requirements. The ASFPM agrees with FEMA's request that the ICC limits be increased to $50,000 from $30,000. We do not agree with FEMA's request to increase the $75 cap on the surcharge, because the program has paid out very little of what it has collected at this time.

We suggest that the Committee urge the FEMA Director to use the discretionary authority given to him in the law to use the ICC more flexibly. ICC funds could be used for the local 25 percent match, which could therefore, obviously, enhance the leverage of the Stafford Act's Hazard Mitigation Grant Program.

Implement the repetitive loss programs created in the Flood Insurance Reform Act of 2004. ASFPM urges FEMA to complete the regulations for this program as soon as possible. We urge that at least $40 million of the expanded regular Flood Mitigation Assistance Program be transferred from the Flood Insurance Fund as provided for in the fiscal year 2006 Homeland Security Appropriations bill. We ask the Committee to remove or at least double the per-State caps on repetitive flood loss spending under the regular FMA program, since the funding for this program was doubled.

On subsidy reduction and program changes, please provide authority to eliminate subsidies over time for pre-FIRM properties, particularly for those properties that are not primary residences. In keeping with the original intent of the NFIP, if the subsidy reduction was focused on structures other than primary residences, those with limited incomes would not be impacted.

Provide additional funding and time for FEMA's map modernization program. Last week, Committee Members fully realized the importance of producing quality maps that will accurately depict special flood hazard areas such as the 100-year floodplain and areas of residual risk. We are concerned that the mandated 5-year timeframe to produce a certain number of new maps that will adequately address restudies of hydrology and hydraulics is not long enough, and therefore, the needed restudies are not getting done.

As the sole person responsible for managing the map modernization program in Rhode Island, I did complete the required business study for my State in terms of our State's mapping needs. Although Rhode Island is the smallest State in the country, we have the oldest maps on average. It is going to be very difficult for us to meet this 5-year metric and also produce quality maps that accurately depict special flood hazard areas such as residual risk, storm surge, and coastal inundation.

ASFPM believes that it would be reasonable to increase flood insurance coverage limits under the NFIP. There are a few areas where the program could be expanded. Again, you have heard this many times this morning: Mapping areas of residual risk and the 500-year floodplain. ASFPM strongly recommends that, as soon as possible, the Nation embark on a program to accurately identify these risk areas. I am proud that my Senator from Rhode Island, Senator Reed, has introduced Senate Bill 2005, that specifically addresses the concerns that ASFPM raises.

These areas of risk need to be mapped: Areas behind levees, areas below dams, areas susceptible to coastal inundation and storm surge and the 500-year floodplain. Further, incorporate the necessary data that is already out there: The U.S. Army Corps of Engineers coastal inundation maps, NOAA storm surge data, and in addition to that, USGS stream gauging data; all of this should be put on FEMA flood insurance rate maps.

Senator Reed's bill also provides the necessary funding to support this, since these areas are not currently funded under FEMA's existing map mod program. It is important to remember that the utility of the 1 percent chance of flooding was not mandated by statute, and therefore, mapping these and other flood risk areas is not incongruent with the intent of the NFIP.

Senator Reed's bill also calls for the reactivation of the Technical Mapping Advisory Council, originally created in the Flood Insurance Reform Act of 1994. This will ensure the involvement of partners and stakeholders in ensuring the quality and utility of the maps produced under the existing Flood Map Modernization Program and under the program to map other risk areas.

The other area for improving mandatory purchase is the 1 percent floodplain. Currently, the NFIP requires insurance to be purchased by those with a federally backed mortgage, leaving out mortgages from non-federally regulated institutions and those structures without mortgages. Previous studies have indicated that perhaps as many as 40 percent of the mortgages come from non-federally regulated sources.

And finally, from a broad perspective, we can do a better job of coordinating all Federal mitigation programs for maximum effectiveness as called for many years ago in Executive Order 11988. We can study ways to handle the demand of catastrophic loss years. We can evaluate how the NFIP's ability to do its job has been compromised by FEMA's inclusion in the Department of Homeland Security.

ASFPM has expressed its concern, in a resolution passed by the board that FEMA's nimbleness that has been hobbled by being part of DHS and that formerly effective Federal, State, and local partnerships and the resources, staffing, and funding for disaster mitigation, response, and recovery have been diminished. We suggest that the effect on loss reduction efforts of the NFIP in particular should be examined.

In conclusion, as this Nation recovers from the impacts of the last 2 years, it is evident that change is needed. It is often said that after September 11, we are a Nation changed. It appears that after Katrina, we are again a Nation changed. This Congress faces similar challenges that the Congress in 1968 faced. How do we make the necessary changes to our framework of national policies and programs necessary to fulfill multiple missions: Protect the American public, protect taxpayers from excessive post-disaster costs, assist communities in recovering from catastrophic events, and balance all of these costs?

Luckily, we have a framework through the NFIP that we did not have in 1968 that is effective for the average loss year. Thank you, sir, for the opportunity to provide our thoughts on these important issues. The ASFPM and its members look forward to working with you as we move towards our common goal of reducing flood losses in this Nation.

Chairman SHELBY. We thank all of you.

If insurance is predicated on risk, as we have always been told, the pricing of that insurance based on the risk logically follows. I do not know how you get around that premise. Having said that, all of us should question the wisdom of encouraging families to continue to live in areas where their lives and property are subject to continued risk.

Mr. Pressly, you mentioned in your testimony the opportunity for homebuyers to live wherever they choose, even within a floodplain, and Ms. Lowrie, your testimony talked to the importance of mortgage availability in flood-prone areas.

I will direct this question first to you, Mr. Pressly, and Ms. Lowrie: Should there be any restrictions or any questioning of subsidizing families to live in harm's way? As a matter of public policy, should our position be live where you want, and the taxpayer will always bail you out? Is that good public policy, Mr. Pressly?

Mr. PRESSLY. Mr. Chairman, that is a great question. I can understand how it would come up today. Any taxpayer would ask that question.

Chairman SHELBY. Should ask that question.

Mr. PRESSLY. Absolutely. Fundamental to that program is this local government decision on where people live in any locality, and it is the local government administrator, whether it is the municipal government, county government, whoever it is who makes a decision to participate in your program. If that local government makes a decision not to participate in the Federal flood insurance program, obviously, nothing gets built there.

So it is easy for us to say here in the capital of the country to say we do not want people building on the coasts in those high hazard areas. There are circumstances in those towns—I think about the coast of North Carolina, and I think about those counties along the coast of North Carolina that come from backgrounds of poverty. There was no industry. There was absolutely nothing at all there. Now, there is an opportunity to enhance the tax base, enhance retail sales simply from these people who want to come out and live there.

Chairman SHELBY. But at what cost?

Mr. PRESSLY. Let us examine that as well. FEMA itself has said, Mr. Chairman, that 76 percent of their policies pay for themselves, are actuarially sound, you see? And indeed, these homes, I do not know the number of the homes, but I would expect most of these vacation homes have been built in the past 37 years since we have had this program. Most are certainly paying their own way in that program. So, I think it is a mispremise to throw stones——

Chairman SHELBY. Are you saying to us today that most of the people are paying their own way? Look at the program. It is broke. It is broken. It is bankrupt.

Mr. PRESSLY. Mr. Chairman, the program, until the past couple of years, has paid its way. And FEMA itself has said that 76 percent of those policyholders are actuarially sound in that sense. The other 24 percent are people who are typically in older houses, houses that are in floodway areas that were built long before the program was established. And there is a reason for that.

As we think how our country developed, we think about the infrastructure of our country, certainly, riverways and waterways and oceans were where the commerce was. And until certainly, after the Second World War, that is where the transportation was, that is where rail was, that is where factories were built, and that is where homes were built.

Now, many people in that 24 percent sector find themselves in those areas and stuck in those homes, and I think that the Congress in its great wisdom 37 years ago when it developed this program recognized that. And the panelists have talked about other areas, areas behind dams, areas behind levees, where we do not charge premiums now. I think those people will find themselves in similar structures. I am certainly not at all saying we do not need to examine that, but we certainly do.

But there is a similar structure that we had 37 years ago when Congress set this program up to say those people are going to be paying rate structures under the same program. So, I thank you for asking me that.

Chairman SHELBY. Ms. Lowrie.

Ms. LOWRIE. Senator Shelby, I think that is—I agree with Mr. Pressly—an excellent question, and I think we have to look at it in two different areas: One, when we talk about pricing to risk and making the National Flood Insurance Program and its rates actuarially sound, there is a difference between those building in new constructions in coastal areas that are actually paying the actuarial rates versus those pre-FIRM structures that were built prior to the maps or were built subsequent to remapping being done.

And those are the properties that, you know, I think have—are the subsidy, and those are people who have been in those areas for long periods of time. I think in addition to that, we have to look at the changing demographics in our society.

The aging baby boomers that now are purchasing second homes in coastal areas at some point plan on that being their primary residence.

Chairman SHELBY. Should we subsidize that?

Ms. LOWRIE. I do not think we are.

Chairman SHELBY. Especially $1 million homes.

Ms. LOWRIE. And I do not think we are, Senator, because the cap is $250,000, and a lot of those homeowners are going out to the private sector and insuring over that.

Chairman SHELBY. Mr. Hunter, do you have a comment on that?

Mr. HUNTER. Yes, the 76 percent actuarially sound are not actuarially sound because the maps are so antiquated.

Chairman SHELBY. You used to run this program, did you not?

Mr. HUNTER. Yes, and I am an actuary.

[Laughter.]

And this is the same kind of argument we have heard since the beginning of the program when we were trying to mitigate. I can recall a hearing in Miami where a developer from Pinellas County came to the hearing and accused us of taking the land and saying it was going to cost too much to elevate the houses, and I asked him a simple question, where is your land? He said I have not dredged it up yet.

[Laughter.]

And that is the problem. If the flood program allows that kind of development out in the Gulf of Mexico where hurricanes are going to come, and people are going to get killed, and we subsidize that, that is not an appropriate program.

Chairman SHELBY. Mr. Gessing, do you have any comments on that? Do you agree with Mr. Hunter again?

Mr. GESSING. There is certainly room for improvement in the program, and if there is a way to—it has been almost 40 years since the program was created, and I think that even if you do keep the program intact, which is not necessarily what I am advocating, you can shift the pre-FIRM properties to paying a more market-based pricing structure, and you can ensure that higher priced properties along the coastlines, second homes, that thing are not receiving subsidies or at least are not put on the same footing as people's first homes.

This would be common sense, or at least part of it would be, to a private entity, but when it comes to the Federal Government and a Federal program, it is politically a bit of a challenge. I do not think you will find too much disagreement on some of these things even among a diverse group like ourselves, but getting it done in Congress can be a challenge.

Chairman SHELBY. Mr. John, do you have a comment?

Mr. JOHN. I have one comment. One of the assumptions seems to be that a pre-FIRM structure continues to be owned by the family that has owned it for the last 40 or 50 years, and that is actually not true in most cases. A large number of these structures are now second homes. They are rented out for vacation dwellings and things like that, and there is actually no excuse in the slightest to continue to subsidize them at the current rate.

Chairman SHELBY. Are we basically subsidizing the upper middle class people all over the country?

Mr. JOHN. Yes, basically.

Chairman SHELBY. Second and third homes; is that right, Mr. Hunter?

Mr. HUNTER. Yes, and wealthy people. I mean, there is a great attraction. I have a house on a lake up in Maine. I like to be near the water.

Chairman SHELBY. We know.

Mr. HUNTER. But I do not think we should subsidize that.

Mr. JOHN. My wife and I vacation in Ocracoke Island, North Carolina, and at one point, we were a couple of years ago wandering around an antique shop that was located in a house, and there was a teacher who had just come to teach at the Ocracoke school. He and his wife could not find a place to live because so many of the houses were converted to rental structures, and they could not afford $2,000 a week.

Chairman SHELBY. Ms. Pogue, I believe that you are right on point as far as remapping, repricing this program is the only way it can survive, is it not?

Ms. POGUE. I could not agree more. As the State Floodplain Manager, I have a very close relationship with all of my building officials who have to implement the building code and the floodplain management regulations. The greatest challenge we face on a daily basis is trying to determine whether or not a particular structure is in or out of a floodplain and which one and at what elevation. So those maps are absolutely critical.

Chairman SHELBY. Mr. Hunter, do we have any sense of the typical income of households basically being subsidized by the flood insurance program?

Mr. HUNTER. I have not seen a demographic distribution of that, but that is obviously achievable by looking at the counties where these are. But clearly, along the coast of Florida or someplace like that, you are talking people in very valuable structures.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Yes; thank you very much, Mr. Chairman. First, let me address the issue that was just being discussed about pre-FIRM subsidized housing. Now, I am looking at FEMA figures, which seem not to square with what some members of the panel are saying. They have 1.2 million subsidized, of which just under 800,000 are primary residences, and 400,000 are other than primary residence, which seems to contradict what some were just saying, which seemed to have these subsidies going primarily to other than primary residence.

Do people disagree with these figures?

Ms. POGUE. No.

Senator SARBANES. Because I think it is important to keep our facts straight. Now, let me ask this question: Who on the panel takes the view that as a realistic matter, the National Flood Insurance Program can be structured to handle damage of the magnitude of Hurricane Katrina?

Mr. HUNTER. I do.

Senator SARBANES. And how would you do that, recognizing that at the moment, it brings in about $2 billion a year; lots of changes have been suggested here, and I am interested in getting at what the order of magnitude of revenues would be as a consequence of those changes but recognizing that Katrina was a $24 billion hit and that the biggest previous year was, I think, just over $2 billion and that it averages at about $1.2 billion a year.

Mr. HUNTER. The program—first of all, it is a scientific question. What would be the actuarial rate which would be sufficient——

Senator SARBANES. No, you can set an actuarial rate. That is why I put in the phrase in a realistic manner, because the——

Mr. HUNTER. I think the actuarial rates are——

Senator SARBANES. Because if you are going to jump the rates—let us say you jump them 20 times.

Mr. HUNTER. No, no, you do not have to.

Senator SARBANES. Ten times.

Mr. HUNTER. No, it is 65 percent.

Senator SARBANES. Go ahead.

Mr. HUNTER. The current actuarial shortfall is $1.3 billion according to FEMA. The current premium collected is $2 billion. So if actuarial rates were charged to everybody, that would be $3.3 billion a year.

Senator SARBANES. Now, how is that going to enable you to handle Katrina?

Mr. HUNTER. If you had been collecting actuarial rates from the beginning and putting aside a reserve as a real insurance company would do, you would collect enough.

Now, the other problem is that the actuarial rates, the part of the premium that is supposedly actuarial is not actuarial currently because of the map problem. It is woefully below. Can you imagine a 12-foot shortfall if you actually had the 100-year storm in Hancock County, Mississippi? The actuarial rates would be hundreds if not a thousand or more. So you would be collecting much more if you were charging the real actuarial rates.

I think it is very feasible and scientifically possible. Now, will there be cause for concern and strain for low income and so on? Yes, and that is why I talked about the need for direct help and that and a long transition program, perhaps, of sales, et cetera. But it is feasible, very feasible, and in fact, that is what insurance companies do with wind storm damage. It is feasible. They do it privately. They put up reserves. They change their deductibles.

Senator SARBANES. But they will not do it with flood insurance, will they.

Mr. HUNTER. They have not done it with flood insurance historically.

Senator SARBANES. Why not?

Mr. HUNTER. Because they had no way to force people to buy, and only the people would—if they set a price at X, only the people next to the river would buy, so if they tried to lower the price, maybe a few more would buy, but nobody on the hill would buy.

Senator SARBANES. How are you going to overcome that in the public program?

Mr. HUNTER. The public program does overcome it by a purchase requirement.

Senator SARBANES. Only by the people who are at risk.

Mr. HUNTER. Yes, well, of the people who are at risk; yes, a purchase requirement. That is another reason to expand to the 500-year level.

Senator SARBANES. I mean, they do fire insurance; everyone buys it, right?

Mr. HUNTER. Everyone buys it, yes.

Senator SARBANES. Yes, everyone.

Mr. HUNTER. Yes.

Senator SARBANES. There is no fire plain like a floodplain, right?

Mr. HUNTER. No, there are fires everywhere. There are some higher risk areas.

Senator SARBANES. Let me examine abolishing the program.

Mr. HUNTER. Okay.

Senator SARBANES. No flood insurance program.

Mr. HUNTER. Right.

Senator SARBANES. And now, you have a lot of the people who live in the floodplain. They get flooded. What do you think the public response is going to be to that damage?

Mr. HUNTER. There will be disaster relief, but people will learn to build like they did in the Garden District in New Orleans. People knew how to build. If you go out into floodplains and look, as I have, and walk through many, you look at the oldest structures, preflood insurance structures, and you see most of them are elevated. Most of them are on the high land. It is only after the flood program——

Senator SARBANES. Senator Lott had a house like that, and it is gone. He told me it was elevated, I do not know, 20 feet or something above the requirement, and it is gone now.

Mr. HUNTER. There are examples of that, and of course, part of the fault is the requirement.

Senator SARBANES. People in the Garden District are fairly prosperous, are they not?

Mr. HUNTER. They were not when they built them.

Senator SARBANES. All right; that is a good point. So you think the lower-income people would be able to adjust to this?

Mr. HUNTER. Over time. I do not think you should immediately impose, but the lower-income people can adjust, yes, and there will be disaster relief, certainly, continuing, but there would be no more incentive to go into floodplains.

Ms. LOWRIE. Senator, just an interesting point I want to make. Back in 1999, PriceWaterhouseCoopers did a study on the impact of charging actuarial rates on the subsidized pre-FIRM structures we are talking about here today, and——

Senator SARBANES. Mr. Hunter says that the people who are supposedly paying actuarial rates are not doing so, so he wants those rates to go up, too, I guess substantially.

Mr. HUNTER. Absolutely——

Ms. LOWRIE. Well, and I am not sure—Mr. Hunter, I thought what you were saying, and I agree with this, is that the need for remapping and for the appropriation to do remapping on an ongoing basis is so critical to the viability and future of the National Flood Insurance Program, because there are a number of properties that have flooded that when flood determinations were done did not show to be in the 100-year floodplain when, in fact, they were.

And had the maps been updated, those borrowers, those homeowners would have been required to purchase flood insurance at the time they purchased the property. So there are a lot of components to this, and I think the other thing that we have to focus on is the mitigation efforts, too.

There has been a tremendous amount of progress when you look at a lot of the coastal areas and the compliance with the State and local authorities in mandating that properties be built up on stilts and at higher elevations that, you know, we are talking about a program that has been viable since its inception up until a catastrophic event that has had a negative impact on our entire economy.

So, I applaud the effort in what this Committee is doing. I just want to caution us to be very careful in proceeding forward that we do not cause unintended consequences to overall values.

Senator SARBANES. I think there is a need, obviously, to strengthen the flood insurance program. But the question I want to get at is whether in the course of doing that, you are advocating taking on the task of structuring it in such a way that it is able to encompass or handle within the program rather than in some outside special way a catastrophe of the magnitude of Katrina. That is the question here. This is 20 times the normal year; 10 times the worst previous year.

Mr. HUNTER. Katrina is much less than the modeled catastrophes that can happen like a Category 5 storm hitting Miami or like a major storm hitting the New York area.

Senator SARBANES. Do you think the program should be structured to encompass within the boundaries of the program and its premium charges and so forth to handle that kind of catastrophe?

Mr. HUNTER. Yes.

Senator SARBANES. The kind of catastrophe so great that it needs to be handled outside of the program, because it is not realistic to try to handle it within the program?

Mr. HUNTER. The rate for covering those kinds of events, since they only occur every 50 or 100 years or less, is small enough that when spread, it does not make the rate unaffordable. Actuarial rates can be affordable as long as they are built for the future. You cannot recoup this last one, I do not think, but I think you can prepare and build reserves for those future ones.

Senator SARBANES. Let me stop you right there. Do you think that we should try to recoup the last one?

Mr. HUNTER. That would not be actuarially sound, in my view. You do not go back. You look to the future, and you try to cover that. If you want to do that, then, you have to add something on top of actuarial rates to try to recoup. But the actuarial rate does not recoup history; it tries to take care of——

Senator SARBANES. Do you think that building in certain areas should be prohibited?

Mr. HUNTER. I think the actuarial rates and the maps will take care of that: the V-zones, the high risk zones of, say, storm search or riverain floodways are places where building is very difficult if possible at all, and I think if the true actuarial rate is charged, in some of those places, you could not build.

Ms. POGUE. Excuse me.

Senator SARBANES. Yes.

Ms. POGUE. Senator Sarbanes, I want to hit on your point, and that is, I am telling you as a regulator and somebody who has to deal with this constantly, particularly in Rhode Island, very few parcels are left that are, dare I say, buildable. They are all challenged. One of the things that I think is not being taken advantage of on a national basis, quite frankly, is mitigation.

I think it is going to be critical at this time, now, and as Mr. Hunter says, to look forward to truly invest in mitigation. A report was released recently by the National Institute of Building Sciences which tells us that for every $1 of taxpayers' money, we receive up to $4 of mitigation benefits. I think that when we look forward, and we look at the density of the coastline, as Senator Reed said, it is a very critical challenge, because we are constantly being called to deal with people who want to build on the shoreline. They are getting rid of the smaller homes and putting up the McMansions and so forth; mitigation is critical.

We have recently held about 18 training courses; FEMA put together a coastal construction manual, which is the state-of-the-art building in terms of not necessarily encouraging development in a coastal area but at least getting toward smart development. Ms. Lowrie alluded to this stilts or pilings or looking at wind loads, water loads, and so forth.

So, I think it is absolutely critical, and the ASFPM strongly supports truly looking not only at mitigation but also other Federal programs that include mitigation as well, because they are linked to the National Flood Insurance Program.

Senator SARBANES. I think that is a good point, but I am just trying to cut through all of this, because a lot of buzz words are being used. You just used one, which is McMansions.

Ms. POGUE. Sorry.

[Laughter.]

Senator SARBANES. And that is not going to get any sympathy out of me. But on the other hand, before, everyone was throwing around the notion that most of the houses getting a subsidized rate were second homes. Now, the figures—well, they are from FEMA, so I am not going to vouch for these figures.

[Laughter.]

But the figures would indicate that two-thirds of them were a primary residence. And the fact remains that a lot of poor people or lower-income people live in coastal areas and in flood zones, and they are there. And many of them have been there for a long time.

Mr. JOHN. Let me point out something.

Senator SARBANES. Now, how do we address that situation?

Mr. JOHN. Could I address the statistic for one thing?

Senator SARBANES. Yes.

Mr. JOHN. All right; you have 1.2 million who are receiving subsidized pre-FIRM rates essentially.

Senator SARBANES. According to this table.

Mr. JOHN. According to that table.

Senator SARBANES. Right.

Mr. JOHN. Now, where those are located is a key matter, because you could very well include houses there such as a farm in rural Missouri, a farm in Alabama, et cetera, et cetera, which is located on a floodplain. But flip that side over. That also means that you have 400,000 structures there that are receiving the pre-FIRM subsidized rates that are vacation homes.

Senator SARBANES. Right.

Mr. JOHN. Now, 400,000 is a fairly substantial number.

Senator SARBANES. Fine; fine. I mean, you are shifting the goalpost, and I do not mind you pointing that out, but the goalpost that was previously being advanced at the table was that a majority of these homes were not primary residences. That is the only point I was trying to make. I mean, we have to have a pretty hard-headed discussion about this thing. That is all.

Now, I accept the point: There are 400,000 that are not, but previously, the discussion was along the path that a majority of these homes were not primary residences, and the FEMA figures show to the contrary; in fact, two-thirds of them, according to these figures, are primary residences. That is the only point I was making.

Mr. HUNTER. Senator, I would recommend that you ask FEMA——

Senator SARBANES. Well, I did not vouch for the FEMA——

Mr. HUNTER. No, ask them to break out within these numbers how many have had floods before, how many are, say, homes of value in excess of——

Senator SARBANES. I think those are all good points.

Chairman SHELBY. We will ask those questions.

Senator SARBANES. The repetitive loss houses are a real problem; we need to address that.

But I am trying to see whether doing all these things, where it gets us in terms of the kind of magnitude of the catastrophe that occurred in Katrina. And furthermore, I feel very strongly that these borrowing limits should be raised now so that the people who had the policies and got flooded in New Orleans can get their claims satisfied.

FEMA tells us they are going to run out of this money by mid-February and that people with legitimate claims are not going to be able to get them settled, and I want to separate that problem out and take care of that. Is there anyone at the table who thinks that we should not separate that problem out and take care of those people?

Ms. LOWRIE. It needs to——

Senator SARBANES. We should honor our contracts.

Ms. LOWRIE. The Federal Government has an obligation, FEMA has an obligation, and that is separate from the issue of reform, which is just as critical, but there is a lot of need.

Chairman SHELBY. Senator Sarbanes points out an immediate problem, and he is absolutely right, and they should honor their agreement. We are looking to the future prospectively, about looking at the whole program, can we afford it? How can we change it to make it work and so forth?

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, thank you, and I want to commend you for delving into this problem. This is the second of a number of hearings I think you anticipate having, and I think we need to have them. I have enjoyed this discussion; I have enjoyed the testimony from the panel. Even though I have come in late, I come from the Budget Committee; I also posed a question there on flood insurance, because of the $23 billion-possible debt limit that we might end up with.

I want to go back to the technical aspects of this. Before you can do anything with a program like NFIP, you have to have adequate and accurate data. I have visited a company that uses a jet plane to take pictures at 34,000 feet in the air. They use the old USGS maps, and they use the GPS system to create new maps, and they are extremely accurate, very accurate, within a matter of feet.

It seems to me it is accurate enough for us to deal with floodplain issues. They showed in the program where, if you hypothetically have a 50-foot tidal wave come in, here are the homes that are going to be impacted. There are a number of areas along the coast where they have already done it. They have been contracted out quite a bit.

And so, I see the technology where we can do this. We can get it, and we can get it in rather rapid order, I believe. I know there are some States that have already been totally mapped with this technology, and there are some that have not done anything.

FEMA is making the argument that they have covered a certain percent of the population, but the problem is they have not covered the land mass; the population is a very small part of the whole country. What is it that we can do? I understand that this program is a partnership, between the States. They lay out the plan, and local governments, they help lay out the plan. Perhaps some of the delay in this is happening because that partnership has not evolved.

There is a financial obligation, that is incurred by the cities as well as from the States. We are now dealing with a deadline, but what is it that we can do over the long haul, to create incentives for them to continue updating maps; these things are going to change with time, so what is it that we can do to continue updating? If we construct dams, what incentives do we get to remap there when we have done that, as that could change the floodplain dynamics below that dam, for example, or maybe a big hurricane may change the flood dynamics and move the coast around?

What kind of local incentives can we put into place for State and local governments to buy into this program and keep us updating it, especially those that have been reluctant to participate? What is it that we can do to get them more participatory in the program?

Ms. POGUE. Senator Allard, I actually have a meeting Monday, Tuesday, and Wednesday with all my communities in Rhode Island to go through the initial first cut, if you will, of scoping what needs to be done and what FEMA is proposing to do. I think the first thing to recognize is the deadline itself, 5 years is insane. It is very difficult, as you are talking——

Senator ALLARD. I think we can do it with the technology I saw.

Ms. POGUE. The problem we are having is the funding.

Senator ALLARD. It is the cost.

Ms. POGUE. A lot of these communities do not have the match that is needed to meet that. And the other thing, too, though, is also trying to——

Senator ALLARD. Why do they not come up with that money? I mean, this is really important stuff.

Ms. POGUE. I could not agree with you more.

Senator ALLARD. Yes.

Ms. POGUE. But I will tell you the problem in Rhode Island, for example, is that we have not had—I have to be careful how I couch this—we have not had a disaster since 1991, so we have no money. We have no Hazard Mitigation Grant Program money floating around or anything like that. So the coffers are truly dry.

Because of the parameters by which the money was assigned and distributed to States, we are getting very little money, which is clearly not going to address the need given the density of how our shoreline and how it has changed.

Senator ALLARD. Why do local governments not put it in their budget? Why does the State not put it in their budget? Afterall, zoning is a big part of municipality function. I do not understand why they fail to put something in their budget. It seems to me it would save them money. They could make better policy decisions at the local level.

Is there an incentive that we can provide other than a subsidy? It seems they have all got their hands out; you know, we do not want to tax our constituents; you just give it to us, Mr. Federal Government.

Are there other incentives that we can put in place that would drive them to put in the proper policy so they can do their share of making this happen?

Ms. POGUE. Primarily what we are dealing with is the lack of money. We have 39 cities and towns, of which two-thirds are looking at serious financial problems dealing with things such as education, property tax increases, and so forth. They just clearly feel they do not have the money. I could not agree with you more. Not only do our cities and towns need to put money up front, but also so does our State legislature.

We have no money. Nobody is willing to take that extra step. In light of that, what they are willing to do, and what we are looking at, are partnerships, looking at data collection. The data you are mentioning is LIDAR. It is basically doing an overflight of the coastline and the State looking at one-foot contours, which is vastly better and much more improved than, say, the 22-foot USGS topos.

So that would be ideal, because it looks at vertical elevation as well as horizontal. As you are saying, you could look at a 28-foot storm surge, which is predicted to occur in Narragansett Bay, to see who all would be impacted.

What we are imploring to be done is to take the data that is already out there that NOAA has that USGS has, that the Army Corps has, and use that data. Right now, the situation that we are dealing with is that our scoping that was handed back to us by FEMA will not include that data. We are pushing hard to say yes, we do want coastal inundation, coastal flooding, storm surge, and residual risks covered on the Rhode Island flood insurance rate maps. It is that important.

Senator ALLARD. Well, I just think that an effort needs to be made to collect the accurate data and somehow or the other figure out and get more cooperation from States and local governments.

Ms. POGUE. I agree.

Senator ALLARD. You know, they have a lot of recreation programs, often a big part of their budget.

Ms. POGUE. That is right.

Senator ALLARD. Now, what is more important? Recreation or trying to protect somebody's homes so they make right decisions, you make right zoning decisions, you do not put their businesses or their properties at risk of a flood? I think that we need to put in some incentives where they will make the right decisions with the taxpayer dollars that they are getting.

Some of the communities in my State of Colorado, are buying farms and ranches for open space and not trying to take care of their floodplain issues. It seems to me that we need to put some incentives in place so they are spending that money in an area that is going to reduce the liability on the floodplain insurance program. And also, I think they would serve their constituents, their citizens in their communities much better if they made good decisions to, in effect, keep them out of trouble when floods occur.

Ms. POGUE. I just wish some of our community officials would think more long-term.

Senator ALLARD. Thank you, Mr. Chairman.

Chairman SHELBY. Ms. Lowrie, in your own business as a mortgage banker, do you charge every borrower the same mortgage rate regardless of risk, and do you charge lower income buyers a lower mortgage rate in order to encourage homeownership?

Ms. LOWRIE. The industry, Senator, has moved primarily as a result of the secondary market, what we have seen with Fannie, Freddie, and the regulators, to a risk-based pricing environment, and the industry is pricing to that risk. Those borrowers with lower credit scores pay a slightly higher premium than those with a higher credit score.

Chairman SHELBY. But as I understand your testimony today, your written testimony and your other statements, you argue for maintaining the subsidies in the flood insurance program to ensure affordability. Yet, this is a practice that mortgage bankers have rejected in their own pricing. Could you just tell us why risk-based pricing is appropriate in setting mortgage rates but not insurance premiums, where there is really risk?

Ms. LOWRIE. That is an excellent question.

Our industry has evolved, and I have been in the industry over 28 years, and over the last 10 to 15 years, we have seen the industry evolve to price to that risk. It did not happen overnight. It happened over a period of 10 to 15 years, and it was very gradual as the market accepted it and as the consumers understood it and accepted it.

My concern in my statement, what I was trying to point out, is that this is something, number one, it is so important we have to study it and make sure we understand it and understand what the unintended consequences of that could be, and previous studies like the PriceWaterhouseCoopers study that was done that showed evidence of a 10 to 32 percent decrease in value.

So for someone who represents the lending, the mortgage association, we are committed to homeownership. It is one of the primary ways in this country that Americans build wealth. So anything we would do to reform the National Flood Insurance Program should take into consideration the impact that that would have on homeowners and the values in their properties, which for a lot of these people is their sole accumulation of wealth.

Chairman SHELBY. Should we take into consideration the hit on the taxpayers, possibly, too?

Ms. LOWRIE. Absolutely.

Chairman SHELBY. Okay.

Ms. LOWRIE. And I think this is such a critical issue. I know I said it before, but there is a lot of areas that need to be studied.

Take, for example, I think today, FEMA is permitted to increase premiums by 10 percent per year, and that has been in place for quite a long time. And we are recommending—there is a lot of different areas that we can study, such as reducing the subsidies and moving more toward actuarials and see what the impact of that would be and the impact of phasing that in; increasing rates, increasing or reducing or eliminating subsidies in areas that are behind levees and dams.

So there is a multitude of issues that I think we have a——

Chairman SHELBY. Should we also look at the possibility, because of a lot of poor people are living in some of these areas and have been, look at risks, I mean, at means testing, too?

Ms. LOWRIE. I think that that is—that is as interesting an idea to look at and study as replacement costs, which I think someone mentioned here today. It is one of the many things that we should look at as we look at the program.

Chairman SHELBY. As we continue here today, we have been told that within the 100-year floodplain, there is a 1-percent chance of flooding. However, the likelihood of flooding over a 30-year mortgage is 26 percent for structures within the 100-year floodplain. During Mr. Conrad's testimony we also heard that 20 percent of repetitive loss properties are located outside of the 100-year mandatory coverage area.

Mr. Hunter, given what we now know, do you think that the terminology used to describe the maps leads individuals to believe that they are safe from flooding when, most likely, they are not safe from flooding?

Mr. HUNTER. Unfortunately, I am one of the ones who helped make sure that that was the terminology, so I do think we should improve it. The 1 percent risk flood is the right terminology, and you can put it in the terms of how frequently it is in 30 years or 50 years, and I think the 500-year storm, instead of calling it that, we should call it the two-tenths of 1-percent-per-year risk, and we can also put that in the 30 and 50 year. I think that the terminology should be improved, yes.

Chairman SHELBY. Mr. Pressly, you stated in your testimony that the cost of building to code outside the 100-year floodplain would simply be overwhelming and unnecessary. After the testimony you have heard here today from Mr. Conrad about the repetitive loss problem outside the 100-year floodplain, do you remain opposed to protective flood mitigation standards outside of the 100-year floodplain? Surely, it looks to me that the cost to build to a higher standard is less costly than rebuilding damaged structures over and over again.

Mr. PRESSLY. First of all, Mr. Chairman, as you and the members of this panel have pointed out that indeed, structures that are within that 1 percent flood risk have additional costs, additional construction components, additional code requirements to make sure they are safe within that area. What fundamentally comes back, as these panelists have addressed, is what should that risk be? Should it be 1 percent? Should it be two-tenths of a percent? And I think we have a series of sister agencies within the Federal Government that will make that calculation.

I do not know how to do it. I know NASA would say here is what percent risk we have. I know EPA would say here is what percent of how clean we have the air, how clean we have the water, and it is a fundamental decision here, whether it is a 1-percent risk, or whether it is a two-tenths of a percent risk. I do not know what it is, but I am here to say that there needs to be a balance within that, Mr. Chairman.

Chairman SHELBY. Do you believe that constantly remapping, bringing maps up-to-date is essential to this program?

Mr. PRESSLY. I think each of your panelists has made that same point. I think each of the members at this table here today is consistent in that comment to say that if we can bring those maps up-to-date, your panelists have said conditions do change over time. If we can bring those maps up-to-date with great expedience, then, there is a high probability that we can reduce our risks and reduce our demands on the system.

Chairman SHELBY. If you spread the risk, you reduce the costs, do you not?

Mr. PRESSLY. Yes, sir.

Chairman SHELBY. Mr. Hunter, having run the flood insurance program, you are uniquely qualified to answer this, I believe. Are the program's current problems solely the result of Hurricane Katrina?

Mr. HUNTER. No, no, no. The problems have been developing over time. Obviously, had maps been kept up-to-date, we would have seen much safer construction when Katrina hit. We would see more people with flood insurance. It was a slowly developing disaster over decades, and Katrina just made the exclamation point on it.

Chairman SHELBY. Mr. Pressly and Ms. Lowrie, I will direct this to you, too, if I could. Both your testimonies suggest raising the current coverage limit. Could you explain to the Committee here today how this would impact the future solvency of the program? Do you believe such a change would move the program toward being actuarially sound? In other words, if we move the coverage limit up, are we not going to have to factor in actuarial costs there, too?

Ms. LOWRIE. Absolutely, Senator.

One other comment, though, if I can make back to your previous question. The average life of a loan from a servicer's perspective in the mortgage industry is 3 to 5 years, running more on the average of 3 years. So if you look at the fact that the maps have not been kept updated with the increase in refinance activity over the last 5 to 10 years, people refinance every 2 to 3 years, and the lender requires a new special flood hazard determination, a lot of loans would have been required to have flood insurance had those maps been kept up-to-date.

Chairman SHELBY. Mr. Hunter, last week, we heard here in the Committee that the cost of running the flood insurance program amounts to almost half of the program's premium income.

Mr. HUNTER. Yes.

Chairman SHELBY. A large portion of these costs are administrative costs that go to the insurance companies involved in the program. How do these administrative costs compare to other lines of insurance? Do you believe enough administrative savings could be found to bring the program to solvency in the absence of increasing premiums, or would that be folly?

Mr. HUNTER. Oh, you cannot do it just by that, because for example, homeowners' insurance, which is more complex and should cost more, is about 28 percent, and flood insurance is about 30. But I think flood insurance could easily save 5 percent in the administrative costs if it was more competitive among the write-your-own companies or something. But it will not solve the whole problem, no, not at all.

Chairman SHELBY. Ms. Lowrie, why are lenders not simply requiring flood insurance beyond what the law requires to protect themselves from loss?

Ms. LOWRIE. As I mentioned in my testimony, even before, there were many lenders, before the National Flood Disaster Act was passed.

Chairman SHELBY. Before 1968.

Ms. LOWRIE. Before 1968, who were requiring flood insurance to protect their collateral. I think that it becomes a competitive issue. It becomes an issue of consumer choice, and the increased costs to the consumer, the fact that it is not part of the law, it is not written in the law that you cover the replacement value versus the unpaid principal balance becomes a consumer issue.

Chairman SHELBY. How many times, Mr. John, should the taxpayer have to rebuild any particular home, and what is the value to the taxpayer of continuing to rebuild the same homes over and over?

Mr. JOHN. Absolutely no value to the taxpayer to rebuild the same home over and over again. I mean, there are a certain number of losses that are going to be catastrophic, accidental, et cetera, et cetera. But there is no reason to subsidize continuous rebuilding. I do not know a particular number, but I would certainly think that over a relatively short period of time that once you start to get over three times, say, in 5 years or something like that or three times in 10 years that you are certainly in a rather serious problem.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thanks, Mr. Chairman. To our witnesses, welcome. I have three hearings going at the same time right now, and this is—just glad to get here and glad that you are still here. Thank you for your testimony and your response to our questions.

I understand we are about at the end of this hearing, and what I would like to ask almost as a wrap-up question is where do you agree on what we should do going forward? Where is the consensus among each of you that an appropriate step that we should take?

Where do you think you agree as witnesses, and we will just start with Ms. Pogue and go to your right.

Ms. POGUE. Thank you.

I think the first thing we agree on, just about everybody here, despite our diverse backgrounds, is the absolute necessity for continuing to identify accurately the hazards and the risks that we are trying to insure people against; the mapping and modernization program for FEMA, that is absolutely critical. I think we all also agree that there needs to be investment in, and there needs to be a greater support of mitigation. As I mentioned earlier, a national report came out saying that for every $1 taxpayer money, we get $4 back in benefits from mitigation.

I will take a stab at a third and final item, and that is I think we are in agreement in terms of relooking at pre-FIRM, pre-flood insurance program properties and whether or not those should continue to be subsidized and how to address the issue.

Senator CARPER. All right; thank you.

Mr. John, where do you think this panel agrees?

Mr. JOHN. Well, I think that I would agree with what has just been said. I think that with the possible exception of one of one or two members of the panel, there is also an understanding that we cannot assume that the Katrina catastrophe is a one-time event and that in addition to paying the contractual costs of the program now, what is owed to people who had the policies, there is also a need to look forward and to make sure that we are adequately prepared next time so we do not get caught flat-footed.

Senator CARPER. I am afraid you might be right on that.

Is it Mr. Gessing?

Mr. GESSING. Mr. Gessing, yes.

One thing we definitely all agreed on is that improved mapping is necessary. Senator Allard made a point earlier about providing incentives for that, and I, in my testimony as a representative of the National Taxpayers Union, called for eliminating the program over the long-term, and I think that one of the ways—now, this is not a point of agreement—the mapping general point is.

Senator CARPER. What I am looking for, Mr. Gessing, is where do you think the witnesses on the panel agree? That is my question. Just answer it, because I do not have much time, please.

Mr. GESSING. Okay; the mapping is necessary, and improved mapping is essential, and I would say that the best way to do that is leverage private markets to do that.

Senator CARPER. Good; thank you sir.

Mr. Pressly.

Mr. PRESSLY. Senator Carper, I think we all agree that without doubt, the mapping is fundamental, updating those maps, and I think that is the fundamental comment that we have all made.

Senator CARPER. Given the technology that we have today, we are actually able to make some real progress there, are we not?

Mr. PRESSLY. Yes, sir.

Senator CARPER. Okay; is it Mr. Hunter?

Mr. HUNTER. Yes.

Senator CARPER. Mr. Hunter.

Mr. HUNTER. I think one thing that we probably had agreement on, although I am not absolutely sure, at least consensus is that when we do make changes, if we go to eliminating subsidies, that we do have to be careful how we do it on poorer people. There has to be some way of transitioning for them if there is a move in that direction.

Senator CARPER. Okay; Ms. Lowrie, where do you think this panel agrees?

Ms. LOWRIE. Well, it has already been said, but the updating of mapping, number one, critical; increased focus on mitigation second. I think careful study as we move forward looking at some of the other things like reducing the subsidy, moving more toward actuarial that it is critical that those issues be studied and see what the overall impact would be, not only to homeownership values but also the overall economy and to make sure that there are no unintended consequences from what we do to try and enhance the viability of the NFIP.

Senator CARPER. Good; thanks.

Is it Mr. Conrad?

Mr. CONRAD. Okay; I think I will agree with all of what has been said we agree upon.

I think I am going to agree that I think everyone pretty much agrees that the circumstance that we find ourselves in at this point with a very extraordinary catastrophic set of years is a wakeup call that this program has failed on a number of fronts to keep pace with where we really need to be and that it is a very serious situation, and it needs attention in all of these areas: The pricing of insurance; I think the location of where insurance needs to go; and also the need for hazard mitigation, improvement of the maps, et cetera.

Senator CARPER. My time has expired.

Mr. Chairman, can I ask one more quick question just of Ms. Lowrie?

Chairman SHELBY. Go ahead.

Senator CARPER. If I could, please.

Ms. Lowrie, I guess for roughly 20 years or so, we have been discussing the proposal to require banks to escrow flood insurance payments for buildings that are located in floodplains, because some of us believe that this would ensure higher participation in the program. When we consider the damage to properties along the Gulf Coast last year and the potential loss that mortgage holders in this area know they one day might experience, could you just discuss with us why you think mortgage lenders have not done this on their own?

Ms. LOWRIE. Well, it is a consumer issue, Senator, and just like hazard insurance has not always been escrowed, many borrowers prefer to pay their own taxes and insurance, and lenders deal with it more as a customer service issue based on certain criteria on the loan that they feel that that customer is a good credit quality that if they have paid their credit and their mortgage on time that they are going to make sure that their insurance is paid on time.

The other reason is that the lenders, seller servicers, have instituted very diligent monitoring systems to monitor expiration dates on policies through third party providers, even if they are not escrowing it.

And then, finally, I think we have to be cautious, the Committee needs to be cautious that mandatory escrows sometimes not only run contrary to proconsumer issues but also to State requirements. For example, California law prohibits the lender from actually requiring escrows as a condition of granting a loan if the borrower has an LTV of 90 percent or less.

So, it falls into one of those categories, Senator, that we have talked about, and there are a number of them that we need to study more closely, and I think the mortgage industry as a whole is open to work with the Committee on this issue and numerous others as we go forward to try and improve the program.

Senator CARPER. All right; thank you.

To my colleagues, I would just say gentlemen, this is an issue that I think has come again, and I mentioned this in one of the earlier hearings on this; I think it was 1988, 1989 when I was on the House Banking Committee, and I think Mr. Shelby, our Chairman, had already left the House at that point in time, but this is one we worked on, legislated on, and we ended up passing a bill in the House that attempted to speak to some of these issues, not a strong bill, and died, I think, in conference.

And I know we have tried with the assistance of Senator Bunning to get back into the game here, and I am pleased that we are going to have this opportunity and encourage that with this hearing and your determination to get us on the right track.

Thank you.

Chairman SHELBY. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

I just have a couple of questions. One, Ms. Pogue, you say in your testimony; "the four successive hurricanes that impacted Florida in 2004 provide an example of a difficult disaster season that could be handled within the existing program with limited Treasury borrowing, fully within the capability of the National Flood Insurance Program to repay," and the FEMA people have testified that through 2004, they have been able to pay claims through premium income or in the alternative borrowed and paid back funds to the Treasury, and they say that over the last couple of decades, they have been able to pay back borrowed funds with interest in a timely manner.

Is that your understanding?

Ms. POGUE. That is my understanding.

Senator SARBANES. Does anyone on the panel differ with that understanding?

Mr. PRESSLY. Senator Sarbanes, I think that demonstrates how solid that program has been.

Senator SARBANES. I am not trying to draw the lessons, but I just want to get agreement on the facts here, yes.

Mr. CONRAD. It is correct, but we had a period before, in 1986, where there has to be some forgiveness of debt so that this is——

Senator SARBANES. Because of the size of the catastrophe or what?

Mr. CONRAD. No, I think it was just——

Mr. HUNTER. Cumulative subsidies.

Mr. CONRAD. Cumulative subsidies that came up at that time. So this, the entire 38-year history of the program would not fit the category you just——

Senator SARBANES. Okay; just over the last 20 years, you would say.

How many people on the panel think the National Flood Insurance Program should be abolished.

Mr. HUNTER. Only as a last resort if you do not fix the mitigation and the maps and all that.

Senator SARBANES. Mr. Gessing, it is not a last resort with you; it is a first resort; is that right?

Mr. GESSING. It is certainly one of the most important options we would like to see the Committee explore.

Senator SARBANES. Anyone else in that camp?

Mr. Chairman, I just want to thank the witnesses. I think this has been a very helpful panel. I think we have looked at the statements. We are going to take a much more careful look at them. But obviously, a good deal of time and effort went into these statements, and there are many proposals that I think—not all, but many proposals that I think are very worthy of very careful attention, and I certainly intend to give that kind of attention as we move ahead here.

Thank you very much.

Chairman SHELBY. Thank you.

We have had mixed views here today, but I believe it is very clear to me that if this program is going to work in the future, the National Flood Insurance Program, there has to be fundamental changes made to the program. Mapping, Ms. Pogue is absolutely right on this. I believe that as far as the actuarial soundness, Mr. John, Mr. Gessing, Mr. Hunter, you are all right on point. We have our work cut out here, but obviously, the program is broke. It is crying out for change, and this is part of our jurisdiction, and we are going to try to meet that responsibility.

Thank you all for appearing. The hearing is adjourned.

[Whereupon, at 12:19 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR JACK REED

Mr. Chairman and Senator Sarbanes, thank you for holding this hearing on reforming the National Flood Insurance Program (NFIP). I want to welcome Pam Pogue, who is representing the Association of State Floodplain Managers, and is Rhode Island's Floodplain Manager. I want to thank the Association and the National Wildlife Federation for their endorsement of S. 2005, my legislation to modernize FEMA's flood mapping program.

Today, more than half of the United States' population lives in coastal counties and that number will continue to grow in the future. Coastal development is changing ecosystems as we convert wetlands into cities and suburbs, and attempt to protect people with levees, dams, and hurricane barriers. This development and the resulting environmental changes are placing communities in harms way as Hurricanes Katrina and Rita visibly demonstrated last year. I believe it is up to us—elected officials, government agencies, realtors, developers, mortgage bankers, homeowners, and environmentalists—to figure out how we manage development along our coasts and in flood hazard area.

Before 1989, no single coastal storm had caused insured losses greater than $1 billion. Since then, Hurricanes Andrew, Wilma, Katrina, and Rita and others have well-exceeded that figure. There is billions of dollars worth of real estate development in high-risk coastal areas, and the Federal, State, and local governments as well as our economy will have a difficult time bearing the costs of an additional hurricane season like this past year.

Reforms to the flood insurance program are necessary. I believe that reforms must balance making the program actuarially sound with ensuring that working American families living in flood hazard areas have access to affordable flood insurance and take advantage of that insurance.

FEMA also needs to work more closely with communities on hazard mitigation programs. A recent study by the National Institute of Building Sciences found that for every dollar invested in disaster mitigation, there were $4 of cost savings, or said differently, $4 in avoided losses to taxpayers. Strengthening NFIP's mitigation standards will improve the program's financial solvency, but more importantly, better protect families and businesses from future natural disasters.

Finally, as I have stated before, FEMA must modernize their flood maps. The Federal Government needs to provide Americans with the most accurate data that reflects flooding hazards from hurricanes and other natural events. Currently, FEMA's flood maps do not reflect the real flood hazard risks. New development, community growth, erosion, and a variety of other factors have altered watersheds and floodplains. This new development and its affects on floodplains are not accurately reflected in FEMA flood maps. In addition, these maps do not include information on coastal flooding reflected in the Army Corps of Engineers' inundation maps. This is important information needed by the public to assess their risks.

I am very interested to hear from our witnesses about how they would propose to reform the flood insurance program to ensure that development along our coasts and rivers is environmentally and fiscally sound so that the Federal Government does not encourage building in areas of substantial risk. Specifically, I hope witnesses will discuss whether Federal Government programs such as Federal flood insurance is unintentionally inducing coastal development in high-risk areas, especially by continuing coverage to repetitive loss properties, as well as whether government-financed flood control, beach restoration, and shoreline projects have created a false sense of security for residents in these low-lying areas and encouraged unwise development along our coasts and floodplains.

PREPARED STATEMENT OF DAVID R. CONRAD

SENIOR WATER RESOURCES SPECIALIST, NATIONAL WILDLIFE FEDERATION

FEBRUARY 2, 2006

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. 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, with four million members and supporters, and 46 State and territorial affiliate conservation organizations. The National Wildlife Federation has a long history of involvement with and concern for the success of the National Flood Insurance Program (NFIP), particularly because of the critical help it provides people and communities in the wake of devastating flood events and as the Federal Government's principal program to promote wise floodplain management for the benefit of people and the environment.

I appreciate the opportunity to present the Federation's views on recommendations for strengthening the financial solvency of the NFIP.

The Federation also wishes to express its sincere support and appreciation for the continuing efforts of Chairman Bunning, Chairman Shelby, Ranking Member Sarbanes, and the Members of the Senate Banking Committee to strengthen and reform the NFIP. The Federation was a strong supporter of the Flood Insurance Reform Acts in 1994 and 2004. Both of these laws made substantial improvements, but it is now abundantly clear more needs to be done.

Status of the NFIP after Katrina

Mr. Chairman, the National Flood Insurance Program is currently facing the most serious crisis in its 38-year history. The four major hurricanes which struck Florida in 2004 set a stage for a major strain on the NFIP's solvency. Hurricanes Katrina, Rita, and Wilma have now demonstrated what has long been predicted—that the program's lack of an actuarially based financial structure leaves it vulnerable to major catastrophic losses—losses which can now only be repaid with enormous bailouts from the American taxpayers. With a lack of accumulated "catastrophic reserves," only $2 billion in annual revenues, the need to borrow in excess of $24 billion from the Treasury to pay claims, and interest payments that will approach $1 billion from the borrowing, it is clear that without a bailout, the NFIP would soon collapse. We are assuming that some level of bailout will be provided, but we would hope that concurrently Congress will take significant actions to put the program on a much sounder footing in the future.

To reach a sounder footing, improvements will have to be made both financially in how, where, and at what and price we provide insurance and through a concerted effort to better manage risk. This; in turn, requires a commitment to apply the best scientific methods of determining risk and the best policy-setting regarding where and under what circumstances we allow building in the vicinity of floodprone areas.

We believe it would be wise to view the experiences of 2004 and 2005 as critical to bringing greater recognition to potential risks that many communities could find themselves facing in the future. Katrina has been a wake-up call for many communities to consider their own risks and vulnerabilities. In October, Dr. Chris Landsea of NOAA's National Hurricane Center told the Committee *"an Atlantic hurricane era is underway, similar to that last seen from the late 1920's to the late 1960's. Our research suggests that many of the hurricane seasons in the next two or three decades may be much more active than they were in the 1970's through the early 1990's. Warmer sea surface temperatures are expected to contribute to conditions that foster increased hurricane development over this period."* Other research has also supported the notion that we may be seeing more storms of increased intensity and duration. Katrina shows the need to plan for the potential of larger, catastrophic storm events to better protect our citizens from their impacts.

Repetitive Losses Are Continuing to Drain the Flood Insurance Fund

In 1998, National Wildlife Federation published a 3-year study we had conducted on the NFIP and Federal flood policies called *"Higher Ground—A Report on Voluntary Buyouts in the Nation's Floodplains."* This was the study that found that from 1978 through August of 1995, while repetitive loss properties represented only 2 percent of all insured properties they had experienced 25 percent of the losses and received 40 percent of total NFIP claims payments.

These properties have continued to be a large and chronic drain on the National Flood Insurance Fund. In 1995, the 74,000 repetitive loss properties had received $2.8 billion in claims and were costing the NFIP $200 million annually. Just prior to Hurricane Katrina (7–31–05), these numbers had grown to more than 111,000 properties nationally that have cost the NFIP a total of $5.6 billion, doubling the total cumulative cost in only 10 years, and again, cumulatively, having received 38 percent of all NFIP claims. The information generated in this study, we believe, was helpful to alerting FEMA and the Congress of problems with the NFIP and was one factor that led to the eventual passage of the FIRA 2004.

There were other significant findings that may be relevant to today's concerns:

- Nationally, flood losses have risen alarmingly through this century, despite huge expenditures on traditional flood control projects. Twenty-five year average national flood losses (in constant dollars) had soared to $4.2 billion annually, more than double what they were early in the century. For the 5-year period 1993—1998, the losses were more than $8 billion each year. Approximately $140 billion in Federal tax revenues has been spent during the past 25 years preparing for and recovering from natural disasters.

- *A large number of properties (5,629—10 percent of all single family residence repetitive loss properties) had already received cumulative flood insurance payments in excess of the highest reported value of the property.* At the top end, a single family residence in the Houston area was valued at $114,000, yet it received $806,000 in payments for 16 floods over 18 years. [In July of 2005 FEMA reported that there were more than 12,500 currently insured properties with either 4 or more losses or total cumulative claims that exceeded the property value.]
- *Properties that sustained "substantial damage" were not subject to NFIP hazard mitigation requirements.* NFIP regulations require any owner of a building sustaining a single loss event exceeding 50 percent of the building's value to either remove the building or reconstruct the building to current code requirements, including elevation to at least the base flood level to reduce flood risk. Nearly 11,000 repetitive loss properties (approximately 15 percent of the total) had sustained substantial damage on one or more occasions during the 18 years studied (costing more than $500 million in NFIP claims though the point of first being substantially damaged), yet overall they continued to sustain losses essentially as they did before they were substantially damaged. This suggested that many NFIP communities were delinquent in their enforcement of substantial damage rules. In all, 5,578 of the repetitive loss properties received $167 million in insurance payments *after* they were substantially damaged. We concluded that with better enforcement of substantial damage rules, it would be reasonable to expect that the subsequent damage would have been greatly reduced.
- *15,275 repetitive loss properties, or 20 percent of all repetitive loss properties, were classified as being outside the designated 100-year floodplain.* These structures had received a total of $530 million in NFIP payments. This raised serious concerns about the accuracy of flood insurance maps and further concern that the public was not being adequately informed of the risks of living in the vicinity of floodplain areas. We do not today have updated statistics for this class of properties.
- The vast majority of repetitive loss properties (94 percent) are older "pre-FIRM" properties, which were initially constructed before the establishment of flood insurance rate maps and NFIP building standards.

Our report showed that historically many repetitive loss building owners have simply continued to reinvest in extremely high risk properties with chronic flooding problems, often without instituting mitigation measures to reduce the associated risk, and at extremely high cost to the NFIP and other disaster relief programs.

It can well be expected that when statistics are aggregated after last year's hurricanes, most of these numbers will be much higher.

It is obvious from last week's testimony that repetitive losses continue to be a major problem for the NFIP . We were most pleased that the Conference Committee on the Department of Homeland Security recently chose to fully fund the FIRA 2004 flood hazard mitigation and pilot programs. These can begin to reduce the $200+ million costs of repetitive losses to the NFIP. Yet, we are concerned that the current dire financial straights of the program and failure to develop regulations may result in these monies not getting to hazard mitigation, or at least on a timely basis.

Desirability of Moving All Policy Premiums to Actuarially Sound Rates

The NFIP began in 1968 with a promise to do two things: Provide affordable insurance for properties with flood-related risks—and, working with local communities—to guide new at-risk development out of harm's way. Failure to accomplish either of these goals would likely result in the overall failure of the NFIP.

The National Wildlife Federation believes the reduction and elimination of subsidies, especially for pre-FIRM structures and repetitive loss properties, is a long overdue reform of the NFIP and should be an urgent goal today. The initial assumption when the program began was that overtime the highly subsidized pre-FIRM properties would be damaged and either be demolished and removed from the floodplain or rebuilt to safer standards, yet our study showed that this was seldom happening. The continuing drain on the National Flood Insurance Fund, combined with the wrong financial signals which subsidies send that discourage hazard mitigation are critical reasons the NFIP is financially unsound. It has been suggested that an initial step could be to eliminate subsidies for vacation homes, nonprimary residences, and commercial properties. We would agree with this. An equally important alternative to help those for whom increased rates would constitute a significant hardship, is to provide substantial and sustained support through hazard mitigation grants to reduce risk.

Suggestions for Reducing Flood Damages Through Increased Mitigation

In addition to eliminating NFIP subsidies, greater attention to hazard mitigation and strengthening NFTP standards should be cornerstones of restoring financial integrity to the NFIP.

Often the greatest strides that have been made toward reducing existing flooding risk have been made in the wake of flood disasters. After the Great Midwest Flood, FEMA approved more than 170 hazard mitigation projects in 9 States where some 10,000 highly flood prone and damaged structures were acquired and removed from floodplains. Many others were elevated, relocated, or floodproofed. These efforts were made possible especially with monies provided through the Stafford Act (Section 404 Hazard Mitigation Grants Program) and the NFIP's Flood Mitigation Assistance Program.

In August 2004 (see attachment), FEMA reported it had to that point mitigated through *acquisition, elevation, floodproofing, relocation, and retrofitting more than 28,000 properties.* The vast bulk of funding for these activities came through the HMGP, which is made available *after* Presidentially declared disasters.

We are concerned that in recent years there has been a reduction of overall HMGP funding and an unfortunate confusion over the relative importance of predisaster vs. post-disaster mitigation. Both are necessary. As a budget-cutting measure, in 2003 the formula for HMGP funds was cut from 15 percent to 7½ percent of Stafford Act expenditures. Yet, it is almost always after disasters that the greatest potential exists to implement meaningful hazard mitigation. While HMGP is not specifically targeted at pre-FIRM structures, by far the most flood hazard HMGP funds (more than FMA and the new pilot program) go toward mitigating these structures. *We strongly urge the Committee to support restoration of the 15 percent HMGP formula, and we would further urge that the increase be applied the to recent Gulf Coast disasters to meet the current restoration and mitigation needs.*

In addition, there are a range of measures that should be taken immediately to strengthen NFIP mitigation standards and improve the program's financial solvency.

Basic community participation standards have remained largely unchanged since the start of the NFIP. Initially the program planners chose minimum standards such as requiring all new construction first floor elevation to be "at or above" the Base Flood Elevation (1 percent chance flood) to encourage all communities to join. While some communities adopted higher standards, others chose only the minimums. Thirty-eight years into the program we would urge that key standards be increased in light of what we have learned and to promote greater safety. We would specifically urge that FEMA:

Require that all new and substantially improved buildings in the SFHA have the first floor elevated to at least one-foot above the Base Flood Elevation (BFE). This would, in part, compensate for the large range of uncertainties associated with defining a base flood;

Adopt a "no-rise" standard for restricting flows in the 100-year flood instead of the current "one-foot rise." The current standard has worked to draw large encroachment onto floodplains that through time results in substantial new flood risk and damages.

Require all "critical facilities" to be elevated above and flood protection structures to be designed and constructed to protect from at least the 500-year (.2 percent annual chance) flood. A host of government and professional reports and studies support the need for much higher than 100-year standards for urban flood protection and for key community infrastructure (for example schools, hospitals, eldercare, police, fire, and other public facilities, important roads, bridges, and transportation facilities).

The NFIP's Community Rating System has identified and rated 18 types of best management practices that can be employed by communities to reduce flood hazards. Communities representing about half the Nation's population have already participated in this voluntary program. *We would urge the Committee to direct FEMA to identify what practices from the CRS could be adapted universally as part of the basic community participation criteria to reduce risks.*

I would also call special attention to the situation we found with *substantial damages.* Because the calculation and decisions related to substantial damage determinations in the current NFIP is left with local government officials, who are often subject to immense pressure in the wake of disasters, often these decisions result in negative determinations when all reasonable evidence points in the direction of requiring the reconstruction to be elevated to modern code. *We believe for the sake of improving the financial stability of the NFIP and consistency of decisionmaking, that FEMA should be directly involved with substantial damage determinations. We* *would also suggest that the determinations be based on cumulative damage claims and not simply single events.*

Places Where Insurance Should Not Be Provided

When the NFIP was first conceived, it was recognized that there were places where insurance should be withheld—particularly in floodways and areas of moving water. These were excluded because of the prohibitive cost of insuring these locations and the risks that building there posed to owners, their neighbors, first responders, and the public. Subsequently, Congress established a Coastal Barrier Resources System that withholds insurance on undeveloped barrier islands. In light of the history of the program, we would urge the Committee to work with FEMA to identify what other such areas have flooding histories or risks or values that would warrant exclusion of availability of insurance.

Expanding Insurance Participation

The National Wildlife Federation was a strong supporter during development of the 1994 Flood Insurance Reform Act of strengthening escrow authorities and improving Federal bank regulator oversight and enforcement of the mandatory purchase requirements. Substantial measures were adopted, yet it still appears that many who should have insurance do not have it when disasters occur.

We believe that still not enough is being done by the Nation's financial sector and government regulators to assure that those living in flood prone areas purchase insurance and maintain their policies. We would urge the Committee to consider stronger enforcement measures and penalties for failures to assure that there is required coverage.

We would also strongly support changes in the NFIP to expand the mandatory purchase requirement to "residual risk" areas behind levees and below dams within the natural floodplains. Too often, communities falsely believe that because there is a levee or other structure shielding them from floodwaters, that they are essentially safe. The fact that today no flood insurance is required only encourages this false sense of reality. In our 1998 report, we found in particular that across the Nation damages from more rare, catastrophic-type flood events are growing at the greatest magnitude—in many cases when flood control structures fail and inundate populated areas or spread out beyond what is identified as the 100-year floodplain.

Improving NFIP Mapping Accuracy and Adequacy of the 1 Percent Chance Flood Standard

Because the flood insurance maps are literally the foundation of the NFIP and they are basic planning documents for the Nation's urban and rural areas, it continues to be critical that the maps be updated and made accurate as possible. With one-third of the Nation's 100,000 maps greater than 15-years old and another 30 percent at least 10-years old, we are seeing more and more instances of storms that result in much greater flooding than would be predicted by current maps. Again, we were rather shocked to learn in our 1998 study that fully 20 percent of repetitive loss properties were located *outside* the designated Special Flood Hazard Areas (1 percent chance flood zones). The repetitive loss properties had, on average more than 3 losses over 18 years, meaning that statistically they are probably located in the 5–10 year floodplains.

The National Wildlife Federation strongly supports continuation of FEMA's Map Modernization program and appreciates the Administration and Congress' continued support and funding. We are concerned, however, that in order to help place the NFIP on a course to fiscal solvency, the program needs to be expanded and extended.

The 1 percent chance standard was admittedly a compromise when the original drafters of the NFIP conceived the program. It was even recognized at the time that the 1 percent chance flood was probably too high a risk for most cities and urban areas, yet it was adopted as a "minimum" in order to entice reluctant communities to join the program. Unfortunately, the minimum became the maximum for many areas, and the choice of terminology has failed to adequately convey the risks of flooding to the public. Many communities sought the minimum levels of protection behind levees or dams, then nurtured the notion that. they were safe and did not need flood insurance or elevation or other protection for their properties.

Today, it is clear that basic to helping put the NFIP in a financially sound position, we need to build out from the 1 percent chance standard. A critical step must be to map beyond the I percent chance area, and we strongly recommend that mapping extend to the .2 percent chance (500-year) flood level, and to all "residual risk" areas behind levees and below dams, in the event of structural failure. Furthermore, mapping should include other hazards, such as land subsidence, coastal erosion, sediment, and mud flow areas, and areas subject to ice jams. In addition, mapping should be based upon reasonable estimates of "future conditions"—when growing communities are changing hydrologic regimes through their growth. Each of these is well within current technical capabilities.

Senator Reed has introduced S. 2005, critically important legislation that would continue the Map Modernization Program, direct the mapping of the additional dimensions and authorize $400 million annually from 2006 to 2012 to accomplish the mapping. *We strongly urge the Committee to support this legislation as part of its efforts to reform the NFIP.*

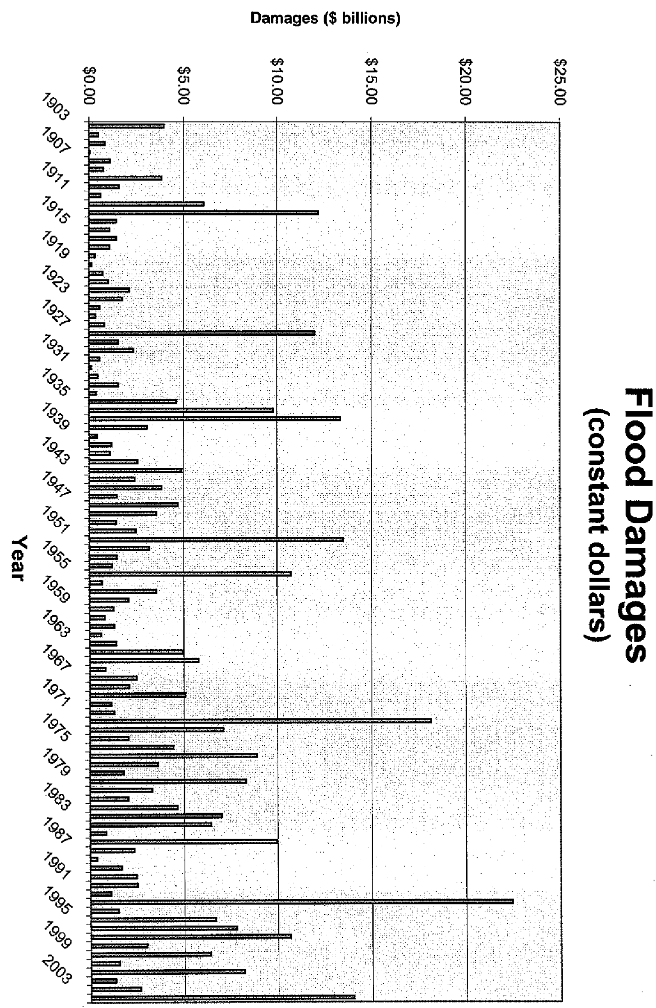
Conclusion

Once again, Mr. Chairman and Members of the Banking Committee, we applaud your work to reform the National Flood Insurance Program. The program has fallen short of its initial promises and currently finds itself in extremely serious financial trouble. The program has been successful in many ways to reduce the adverse impacts of flooding on many of the Nation's communities, yet it has overall failed to put insurance on an actuarial footing, failed to accurately assess flood risks, failed to adequately communicate those risks to the public and failed to adequately discourage building and rebuilding in high and substantial risk areas. For 38 years, it has continued to highly subsidize many of the policies it sells, thus skewing market signals as to the risks involved with certain floodplain locations and in some cases serving as an inducement to develop in high risk areas, rather than the opposite.

Perversely, this has also had a substantial adverse impact on many sensitive and critical ecosystems that support a large portion of the Nation's wildlife—with the result sometimes being intensive urbanization and fill immediately along the Nation's rivers, streams, coastlines, estuaries and barrier islands, with heightened flooding risks.

We are ready to work with the Committee to make needed improvements. Thank you for allowing me to provide the views of the National Wildlife Federation and I would be happy to respond to any questions you may have.

Attachment 1



Source: Hydrologic Information Center, NOAA

Attachment 2

Repetitive Loss State Summary

Data as of 07/31/2005

State Name	RL Bldgs Total	RL Bldgs Insrd	RL Losses Total	RL Losses Insrd	$ Losses Total	$ Losses Insurd	Bldgs W/4 + Losses Total	Bldgs W/4 + Losses Insrd	Bldgs W/2-3 Losses > Tot Val	Bldgs W/2-3 Losses > Ins Val	Bldgs Post-Firm A-V Zone Total	Bldgs Post-Firm A-V Zone Insrd
Alabama	2803	1742	7396	4688	210,725,742.20	141,377,355.69	418	289	68	33	1125	834
Alaska	20	12	51	32	558,010.84	356,536.45	3	2	0	0	8	6
Arizona	172	39	394	92	5,173,543.20	1,380,086.69	8	1	15	4	2	2
Arkansas	321	100	898	290	12,145,504.83	5,547,493.97	65	26	6	1	7	3
California	2766	1385	7147	3730	131,403,360.31	73,710,337.34	372	228	106	57	110	70
Colorado	38	14	87	29	851,345.92	211,291.26	4	0	0	0	1	1
Connecticut	1059	552	3044	1653	44,679,079.42	26,263,750.46	220	128	20	13	26	21
Delaware	332	152	878	437	32,045,237.51	19,959,778.50	53	34	4	2	67	38
District Columbia	10	2	25	8	585,392.24	262,094.85	1	1	0	0	0	0
Florida	12528	8510	30475	20898	902,002,460.45	644,631,173.49	1181	859	388	228	2917	2208
Georgia	1003	555	2568	1414	55,256,363.19	33,612,724.36	120	67	43	18	111	71
Guam	14	9	29	19	403,093.63	304,894.14	0	0	0	0	2	1
Hawaii	152	70	415	207	10,118,606.04	5,725,954.88	25	14	7	5	4	3
Idaho	14	5	40	19	579,663.18	269,658.65	3	2	0	0	2	1
Illinois	1794	569	5341	1877	55,853,632.16	23,170,749.42	383	142	49	11	20	7
Indiana	782	378	2108	1053	24,548,987.79	13,532,209.44	132	71	24	7	15	11
Iowa	466	240	1128	597	18,286,302.67	10,231,156.02	35	24	15	6	21	13
Kansas	338	88	917	256	18,203,570.50	7,858,184.95	50	18	8	3	8	3
Kentucky	1230	583	3778	1961	62,400,895.05	36,739,084.35	288	180	45	17	48	29
Louisiana	20648	11097	63218	35976	833,284,058.68	526,697,789.00	5000	3152	626	183	1624	1129
Maine	127	59	330	166	6,037,309.31	3,368,750.66	14	9	2	0	2	2
Maryland	641	366	1508	856	38,842,122.30	25,594,077.82	48	26	25	9	51	38
Massachusetts	2205	1448	6157	4266	92,114,615.93	64,213,263.99	433	352	52	27	135	104
Michigan	391	135	981	362	11,296,617.03	6,566,482.70	45	21	7	2	6	2
Minnesota	368	161	891	405	12,949,316.31	6,539,008.29	29	17	11	4	10	7
Mississippi	3304	1221	9622	3777	131,097,345.86	63,249,283.06	664	287	287	49	265	160
Missouri	3979	840	12579	3020	192,971,657.03	62,188,818.85	1094	295	319	60	66	26
Montana	35	5	76	12	706,576.26	145,891.03	1	0	1	0	2	2
Nebraska	302	48	744	115	7,961,118.72	1,259,849.72	32	3	21	6	5	1
Nevada	22	9	54	22	1,741,491.71	650,351.10	3	2	0	0	3	2
New Hampshire	103	46	251	120	2,808,305.13	1,717,095.45	10	4	3	1	3	2
New Jersey	6778	4169	20279	12867	307,086,377.00	206,818,220.11	1537	1031	115	74	323	215
New Mexico	15	8	39	20	517,823.20	205,115.02	3	1	0	0	0	0
New York	7211	2901	18975	7944	209,596,020.47	112,348,838.56	1053	501	116	54	177	105
North Carolina	6312	4457	16563	11925	307,897,431.89	213,016,349.56	866	657	142	67	1347	1024
North Dakota	113	25	250	55	5,244,998.56	929,110.98	5	1	11	0	1	0
Ohio	1487	839	3917	2272	60,252,770.77	43,374,989.35	202	130	42	18	58	46
Oklahoma	755	200	2192	662	34,022,366.65	12,857,463.03	151	59	33	10	31	13
Oregon	253	139	610	340	13,430,789.46	8,480,003.14	21	14	20	13	25	16
Pennsylvania	5357	3485	13485	8613	298,268,852.74	211,892,468.08	573	327	166	99	89	78
Puerto Rico	1947	383	5577	1098	49,207,799.17	16,261,050.44	385	70	26	12	63	32
Rhode Island	169	75	492	240	9,963,947.42	5,056,012.27	30	17	3	1	3	1
South Carolina	1274	640	3111	1654	70,393,665.22	34,624,544.00	125	88	36	16	157	81
South Dakota	69	20	147	47	2,162,452.42	876,534.94	2	2	5	1	2	1
Tennessee	708	354	1950	1022	27,298,940.35	18,248,161.27	120	69	22	8	36	24
Texas	15352	5938	44557	18454	1,022,034,042.50	535,772,836.49	3067	1454	698	267	939	530
Utah	6	4	14	9	184,364.53	160,514.95	0	0	0	0	0	0
Vermont	48	21	112	53	1,437,608.33	830,578.50	4	3	0	0	1	1
Virgin Islands	204	83	544	230	24,214,407.64	13,816,752.06	33	13	6	4	25	5

NOTE: DATA LIMITED TO REPETITIVE LOSS PROPERTIES WITH AT LEAST TWO LOSSES IN A 10 YEAR ROLLING PERIOD & AT LEAST TWO LOSSES THAT ARE MORE THAN 10 DAYS APART.

THE DATA CONTAINED ON THIS REPORT DOES NOT CONTAIN PROPERTIES THAT HAVE BEEN MITIGATED (PROPERTIES THAT ARE NO LONGER REPETITIVE).

Repetitive Loss State Summary

Data as of 07/31/2005

State Name	RL Bldgs Total	RL Bldgs Insrd	RL Losses Total	RL Losses Insrd	$ Losses Total	$ Losses Insurd	Bldgs W/4 + Losses Total	Bldgs W/4 + Losses Insrd	Bldgs W/2-3 Losses > Tot Val	Bldgs W/2-3 Losses > Ins Val	Bldgs Post-Firm A-V Zone Total	Bldgs Post-Firm A-V Zone Insrd
Virginia	2135	1284	5463	3294	122,953,671.70	73,607,461.16	241	158	89	30	154	117
Washington	617	307	1609	822	32,907,784.01	17,637,993.13	93	53	38	14	35	21
West Virginia	2564	1447	6512	3730	102,405,664.24	62,939,507.45	302	175	95	40	82	57
Wisconsin	362	201	812	465	11,116,572.11	6,089,851.01	17	11	6	1	2	2
Wyoming	5	3	13	9	157,285.42	115,372.42	1	1	0	0	0	0
TOTAL	111708	57423	310353	164182	5,630,386,961.20	3,403,294,904.50	19565	11089	3821	1475	10216	7166

NOTE: DATA LIMITED TO REPETITIVE LOSS PROPERTIES WITH AT LEAST TWO LOSSES IN A 10 YEAR ROLLING PERIOD & AT LEAST TWO LOSSES THAT ARE MORE THAN 10 DAYS APART.

THE DATA CONTAINED ON THIS REPORT DOES NOT CONTAIN PROPERTIES THAT HAVE BEEN MITIGATED (PROPERTIES THAT ARE NO LONGER REPETITIVE).

Attachment 3

National Average Residential Property Costs And State Activity Totals
For Acquisition, Relocation, Elevation, Floodproofing, Retrofit, and Safe Room Projects
All Mitigation Programs

Average Property Cost by Mitigation Activity Type					
Project Type Classification (Residential Only)	Approved Net Eligible Project Cost	Federal Share Obligated	Number Of Mitigated Properties	Average Project Cost	Average Fed Share
Acquisition	$1,656,568,610	$1,188,766,042	24,779	$66,854	$47,975
Elevation	$148,627,695	$136,431,368	2,241	$66,322	$60,880
Floodproofing	$9,054,150	$5,075,554	181	$50,023	$28,042
Relocation	$21,298,491	$15,985,858	191	$111,510	$83,696
Retrofit	$60,312,583	$45,202,435	1,807	$33,377	$25,015
Safe Room/Shelters	$46,162,335	$33,651,749	7,745	$5,960	$4,345
Grand Total	$1,942,023,864	$1,425,113,006	36,944	$52,567	$38,575

Number of Mitigated Properties by Activity Type						
State Code	Acquisitions	Elevations	Floodproofing	Relocations	Retrofits	Safe Rooms/ Wind Shelters
AK	0	0	0	71	0	0
AL	676	62	0	5	0	399
AR	84	4	0	0	0	1
AZ	98	0	0	0	0	0
CA	338	687	0	0	1,330	0
CO	31	0	40	15	0	0
CT	2	26	0	0	0	0
DE	1	52	0	0	0	0
FL	253	188	2	2	89	0
GA	785	59	0	0	0	0
GU	0	0	1	0	0	0
IA	1,267	15	0	2	0	0
ID	42	30	0	8	0	0
IL	2,859	2	0	0	6	0
IN	345	0	1	0	0	0
KS	1,167	0	0	0	0	7
KY	586	13	0	0	0	0
LA	152	149	4	0	0	0
MA	16	57	70	1	3	0
MD	62	0	0	1	0	0
ME	44	0	0	7	0	0
MI	23	39	0	0	0	0
MN	831	2	0	0	2	0
MO	4,770	2	0	0	0	0
MS	353	40	0	1	0	743
MT	2	6	0	8	0	0
NC	3,871	253	0	64	0	0
ND	843	0	0	2	0	0
NE	277	0	0	0	0	0
NH	2	0	0	0	0	0
NJ	98	47	0	0	0	0
NM	6	0	0	0	0	0
NV	23	7	0	0	0	0
NY	131	83	0	0	0	0
OH	865	32	0	0	0	0
OK	106	0	0	0	0	6,554
OR	110	129	0	1	1	0
PA	745	28	10	0	0	0

National Average Residential Property Costs And State Activity Totals
For Acquisition, Relocation, Elevation, Floodproofing, Retrofit, and Safe Room Projects
All Mitigation Programs

Number of Mitigated Properties by Activity Type						
State Code	**Acquisitions**	**Elevations**	**Floodproofing**	**Relocations**	**Retrofits**	**Safe Rooms/ Wind Shelters**
PR	312	0	0	0	14	0
SC	36	0	0	0	5	0
SD	34	0	0	0	0	41
TN	389	0	0	0	0	0
TX	709	0	0	0	0	0
UT	1	0	0	0	0	0
VA	278	53	7	3	0	0
VI	0	0	0	0	357	0
VT	31	0	5	0	0	0
WA	246	175	0	0	0	0
WI	400	1	41	0	0	0
WV	467	0	0	0	0	0
WY	12	0	0	0	0	0
TOTALS	**24,779**	**2,241**	**181**	**191**	**1,807**	**7,745**

PREPARED STATEMENT OF REGINA M. LOWRIE, CMB

CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

FEBRUARY 2, 2006

Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. Thank you for inviting the Mortgage Bankers Association (MBA)[1] to testify today. My name is Regina Lowrie and I am President and Founder of Gateway Funding Diversified Financial Services, headquartered in Fort Washington, Pennsylvania. I founded Gateway in 1994 with seven employees and $1.5 million in startup capital. The company now has more than 800 employees, more than 58 offices and is Greater Philadelphia's largest independent mortgage company, serving all of Pennsylvania, Delaware, New Jersey, and Maryland. Gateway annually originates $3 billion in loans. I serve on the Fannie Mae National Advisory Council, the Pennsylvania Housing Forum, and the Montgomery County Community College Foundation Board of Directors. I am here today as the 2006 Chairman of the Mortgage Bankers Association.

Over the years, the nationwide availability of affordable flood insurance has been important to expanding homeownership and building communities. The National Flood Insurance Program (NFIP) serves a very important function in the mortgage lending industry as it reduces the overall cost of financing a property located in a flood prone area by providing affordable and reliable flood insurance. Even before the statutory mandatory purchase requirement was enacted, lenders often required flood insurance to protect their collateral interests. With the passage of the Flood Disaster Protection Act of 1973, however, it became unlawful to make, increase, extend or renew a loan secured by a structure located in a Special Flood Hazard Area (SFHA) without flood insurance coverage for the life of the loan. Without a reliable and uninterrupted source of flood insurance, we believe mortgage credit would, at best—be more expensive, or at worst—unavailable in many markets.

Although there are private providers of flood insurance, MBA estimates that 90 percent of all residential flood policies are written through the National Flood Insurance Program (NFIP). The mortgage industry wants to ensure the continued viability of the NFIP. At the same time, overly expansive extension of the flood insurance requirements could have unintended consequences, increasing the costs of homeownership, affordable rental housing, and occupancy costs for businesses. It could also increase delinquencies and foreclosures, increase business failures, and reduce property values.

Another unintended consequence of a further expansion of the NFIP is the impact on State-regulated life insurance companies that include commercial and multifamily loans in their overall investment portfolio used to pay policyholders. The National Flood Insurance Reform Act of 1994 (NFIRA) did not address loans made by non-federally chartered lending institutions. Life companies are regulated by State insurance commissioners. The mandatory inclusion of life company loans in the NFIP would preempt State regulatory authority for life companies. If expansion of the law is being considered to include State-licensed companies, such a preemption should be carefully considered, given the historic role that States have played in the regulation of life companies and other mortgage lenders and servicers.

Reform of the flood insurance program should be exercised with caution and full awareness of the implications of any actions. We do not believe there is a quick fix.

The unprecedented number of natural disasters last year placed the NFIP in a deficit. Currently, it is estimated that total claims will top $23 billion for 2005. The NFIP has already borrowed $18.5 billion from the Treasury and will need an additional $5.6 billion in borrowing authority to pay current outstanding claimants. Of course, the largest contributing factor to this financial situation is Hurricane Katrina, which alone resulted in nearly $22 billion in claims. The number one priority must be to ensure that NFIP has sufficient funds to pay outstanding claims.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: Mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: *www.mortgagebankers.org*.

We, therefore, urge Congress to provide the additional borrowing authority NFIP will need to pay claims that are due to policyholders.

We would also like to take this opportunity to discuss reforms currently being mentioned, including expanding the scope of the mandatory purchase of flood insurance requirement to the 500-year floodplain and removing current premium subsidies.

Expanding the Special Flood Hazard Area

In November of last year, the House Financial Services Committee reported out H.R. 4320 by voice vote. Among other things, this bill requires a study of increasing the size of the Special Flood Hazard Area (SFHA) to the 500-year floodplain and areas that would have such a chance of flooding "but for the existence of a structural flood protection system." At this time, MBA does not support expanding the Special Flood Hazard Area to include the 500-year floodplain. MBA believes further study is necessary before expanding the Special Flood Hazard Area designation and the mandatory purchase requirement to the 500-year floodplain.

Based on preliminary analysis, MBA estimates that approximately three to four million properties[2] are located in the 500-year floodplain and, thus, the scope of the mandatory purchase requirement would increase substantially. Of course, not all properties are subject to the mandatory purchase requirement. In fact, approximately 35 percent of homeowners do not have a mortgage[3] and thus cannot be required to purchase insurance under current law.

It is unclear without further study, what such an expansion would do to housing affordability, home retention, commercial and multifamily property values, small businesses, and regional markets.

A concern with moving to a 500-year floodplain is the fact that some maps do not currently indicate the 0.2 percent risk (1 in 500 year occurrence). Because community mitigation, building codes, and mandatory purchase requirements are tied to the 100-year floodplain, some maps fail to reflect the 500-year designation; therefore, significant map adjustments may be required.

There are other unanswered questions associated with expanding the SFHA designation that deserve further investigation, such as whether including the 500-year floodplain within the SFHA designation will trigger unintended building standards and higher premiums that will drive up the cost of homeownership and home retention, as well as commercial development and operating costs.

As mentioned earlier, H.R. 1A4320 calls for such a study and we believe it should be conducted before any action is taken. We believe, however, that special attention should be given to the feasibility and implications of expanding the mandatory purchase requirements on structures located in areas of residual risk, that is, properties behind levees, dams, and other man-made structures. MBA is aware that many properties in the New Orleans area, for example, did not have flood insurance because the presence of the man-made levees reduced the annual risk below 1 percent (100-year floodplain). Yet, it was the inadequacy of the levees and not the immediate impact of the hurricane that caused the flood damage.

There also should be evidence that the standard flood insurance policy would cover the type of damage likely to be experienced by the property owners in the newly expanded SFHA. For example, given that structures in a 500-year floodplain are not subject to the same elevation concerns, many properties have basements. The NFIP policy, however, excludes finished basements, where flooding would most likely occur in these cases.

Increasing Premiums/Reducing Subsidies

In testimony before this Committee last week, NFIP's Acting Director for Mitigation suggested phasing out subsidized premiums in order to charge policyholders more market-oriented actuarially sound premiums.

There are two basic forms of rate subsidies offered to property owners under the NFIP. The first is given to so-called pre-FIRM structures—that is structures built prior to the completion of the flood insurance rate maps (FIRM). They are generally older housing stock. The other form of subsidy is the "administrative grandfather." In this case, post-FIRM structures that are remapped into a SFHA or subject to base-flood elevation changes are allowed to retain the rates associated with the property's former designation. These policies were put in place to avoid undue financial burden on property owners who complied with construction codes and flood information when their structures were built.

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[2] Information compiled by MBA from flood determination companies.

[3] MBA's "Housing and Mortgage Markets: An Analysis" (using the Census Bureau's *American Housing Survey*), September 2005.

Now that the NFIP has had to borrow substantial funds from the Treasury, the thought of an actuarial rate structure is attractive, but the reality may be problematic. Last week, the Acting Director of the Congressional Budget Office (CBO) indicated that nearly 25 percent of policyholders receive subsidized rates. He indicated that if subsidies were removed, the average policy cost on a pre-FIRM structure would go from $710 to $1,800 a year. There are many individual cases where the rates would be significantly higher. For example, a pre-FIRM structure with total flood coverage of $150,000 is currently subject to a pre-FIRM premium of $590 a year. The same property, if subject to the full post-FIRM actuarial rate structure, would incur an annual premium of $2,200 if the lowest floor were two feet below base flood elevation; $5,875 if the floor were five feet below base flood elevation; and $17,050 if the floor were eight feet below the base flood elevation.[4]

Moving to a fully actuarial premium structure could have a significant impact on Hurricanes Katrina and Rita victims who wish to remain or return to the Gulf area. NFIP's remapping efforts in the Gulf are underway and are expected to result in increased base flood elevations in several Louisiana coastal parishes and portions of Mississippi. Base flood elevation levels for certain parishes in Louisiana may rise one to nine feet based on flood frequency analysis conducted by the Federal Emergency Management Administration (FEMA).[5] Under a true actuarial scheme, many homeowners and commercial property owners who are unable to raise their properties to the base flood elevation could find it financially impossible to retain or repair their structures. These properties could be rendered unmarketable. Defaults and foreclosures would mount further. Given the "unmarketable" nature of the properties, homeowners, commercial property owners, and lenders would bear the cost of the government's change in policy. For commercial properties, the cost of raising the occupied floor level to the mandated base flood elevation could render the property economically infeasible. Additionally, parking ingress and egress issues would be created by significantly elevating the occupied portion of the commercial structure.

In 1999, FEMA commissioned a study of the impact of charging actuarial rates on pre-FIRM structures. As can be expected, this independent study by PriceWaterhouseCoopers,[6] shows that certain communities would fare worse than others. Of significance in that study, is a finding that the most severely affected communities could see a 10–32 percent loss in home values.[7] Such a reduction would have a dramatic impact on the local tax base; affecting the funding of education and emergency services. Additionally, household wealth formation in these communities would be dramatically impacted. These negative impacts would reverberate throughout the economic base of a community.

One of the key benefits of a government flood insurance program is to provide affordable insurance coverage to all property owners in participating communities. Clearly a number of homeowners and commercial property owners with older structures would be severely impacted by a change in rates through no fault of their own. We, therefore, respectfully urge Congress to further study the consequences before making a decision to move to a fully actuarial premium structure. MBA does not support such a concept at this time.

MBA, however, does support an increase in the annual premium cap. Today, FEMA is permitted to increase premiums by 10 percent per annum. We support allowing an increase in premiums of 15 percent per year.

There have been several attempts to deal with the problem of repetitive loss properties. MBA believes the best way to deal with repetitive loss properties is through the existing mitigation programs and to implement the programs passed into law in 2004. To the extent that properties with subsidized rates are producing significant losses for the NFIP, which we expect some do, the homes should be eligible for buy-out or elevation changes.

Lender Compliance

Mortgage lenders have been the only enforcers of the mandatory purchase requirements since enactment of the Flood Disaster Protection Act of 1973 (P.L. 93–234). The 1973 Act, for the first time, restricted federally insured depository institutions from making loans in a Special Flood Hazard Area without flood insurance. It also prohibited Federal agencies, such as the Federal Housing Administration and

[4] Data provided by FEMA based on 2003 rates.
[5] FEMA's Flood Recovery Guidance, Frequently Asked Questions (Dec. 1, 2005).
[6] Executive Summary, "Study of the Economic Effects of Charging Actuarially Based Premium Rates for Pre-FIRM Structures," PricewaterhouseCoopers (May 14, 1999).
[7] *Id* at 20.

the Department of Veterans Affairs, from providing financial assistance for acquisition or construction purposes.[8]

The National Flood Insurance Reform Act of 1994 (NFIRA) expanded the mandatory purchase requirement to loans purchased by Fannie Mae or Freddie Mac. Both Fannie Mae and Freddie Mac, however, already required the purchase of flood insurance at the time of enactment of NFIRA. NFIRA also reaffirmed the lender's obligation to keep the policy obtained at origination in force for the life of the loan through the use of lender-placed insurance, if necessary.

We are very concerned, with certain remarks made last week before this Committee. During questioning, the NFIP Acting Director of Mitigation indicated in response to questioning that he believed the level of noncompliance with the mandatory purchase requirement was between 40–60 percent. We recognize the comments were made without the benefit of data before the witness, and, thus, would like to take this opportunity to comment on lender compliance.

As an industry, mortgage companies execute the flood insurance obligations consistently, in good faith, and with few errors. In fact, an independent study produced for FEMA by the American Institutes for Research (AIR) in March of 2005[9] shows significant compliance with the law. Of relevance to the mortgage industry, the study interviewed representatives from Fannie Mae, Freddie Mac, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) to determine the level of compliance.

In the study, Fannie Mae indicates that it "finds high compliance with the mandatory purchase requirements among its seller/servicers. It infrequently encounters a loan that does not have flood insurance when it is supposed to, and it does not often detect a pattern of noncompliance or any systemic issues related to noncompliance with the requirement."[10] The study also interviewed Freddie Mac representatives and found that "when it [Freddie Mac] does find noncompliance, however, it is usually the lenders' failure to provide proof of insurance, and they [the lenders] typically address the problem."[11]

The bank regulators had similar findings. The FDIC which supervises and examines 5,300 banks and savings institutions, or more than half of all the financial institutions in the United States, imposed 58 civil money penalties (CMP) between 2001 and 2004 for a pattern or practice of violating the Flood Disaster Protection Act. The majority of these infractions, or 70 percent, were for $5,000 or less, indicating that noncompliant institutions had only a handful of violations when they had them at all. The Federal Reserve Board imposed 20 CMP's in 2004. The OTS issued 5 CMP's between 2001 and 2004 and the OCC assessed 11 CMP's as of December 2004.[12]

The NFIRA is a complicated law with a multitude of requirements including the requirement to: Notify NFIP's designee when servicing is transferred; notify the borrower when the property is deemed to be located in a SFHA; mandate the purchase of insurance and place such insurance on the borrower's behalf when necessary—to name a few. Our members have instituted significant procedures to ensure compliance with these and other statutory obligations. It is, however, important to note that despite a high level of due diligence, human error cannot be completely eliminated in a complex compliance setting such as the statutory flood insurance requirements.

At this time, I would like to describe what servicers do to ensure that flood insurance is obtained where required and stays in force.

At origination, the lender will request a flood determination on every loan in its pipeline. That means sending a request to a specialty flood determination company to read the flood maps to determine if a particular structure is in a SFHA.

If the property is located in an SFHA, the lender will notify the borrower of the SFHA designation, require him or her to purchase flood insurance and require evidence of such insurance before closing. The first year's premium is paid up front, prior to closing.

After the loan closing, the servicer enters information into its computer system indicating the flood zone designation associated with the structure, if the loan is

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[8] Federal Insurance Administration (FIA) notice 1978b stated that Federal financial assistance includes "loans, guarantees, and similar forms of direct and indirect assistance from Federal agencies." 43 Fed. Reg. 7140–41.

[9] "The National Flood Insurance Program's Mandatory Purchase Requirement: Policies Processes, and Stakeholders," American Institutes for Research, (March 2005).

[10] *Id* at 84.

[11] *Id* at 85.

[12] *Id* at 69–79.

subject to the mandatory purchase requirement, the policy expiration date and other pertinent policy information. At that time, the servicer reviews the insurance policy to make sure that the servicer's name is listed as the "mortgagee/loss payee." This ensures that future billing notices and insurance claim checks will be sent to the right servicer.

On escrowed loans, the servicer will pay the insurance premium based on the expiration date in the system and the renewal billing sent to the servicer by the insurer. This is monitored closely. To protect against the occasional nonreceipt of renewal notices, servicers produce weekly or monthly reports that alert them to upcoming expiration dates of both hazard and flood insurance policies.

Even if a loan is not escrowed, the insurer will normally send the servicer a notice of policy renewal when a premium is paid. Servicers track the expiration date of the policy and the receipt of the renewal notices. If a notice of policy renewal is not obtained from the insurer, the servicer will notify the property owner that a policy renewal has not been received, as required by the terms of the mortgage agreement, and if not provided, will result in the lender obtaining adequate insurance on the borrower's behalf. Generally two notices are sent to the borrower within 45 days after the expiration date of the policy before the servicer imposes lender-placed insurance. These notices also generally point out that lender-placed coverage is often more expensive and may provide less coverage than a borrower-placed policy.

Finally, if the borrower cancels the flood insurance policy, the insurer is required by contract to notify the lender—as mortgagee/loss payee—of the cancellation. This cancellation notice occurs regardless of whether the premiums are escrowed. It is important to note, that in many cases, cancellations are due to a borrower's change in insurance carrier. If a cancellation notice is received and the borrower has not otherwise notified the servicer of a change in insurance carrier and provided proof of insurance, the lender will send the notices described above warning the borrower that if he or she does not provide proof of insurance in 45 days, the lender will impose lender-placed coverage.

Again, if the lender does not receive proof of insurance by the date specified in the letter, a flood insurance policy is purchased by the lender and charged to the borrower. The servicer also notifies the borrower when it has obtained lender-placed coverage. Should the borrower subsequently provide proof of insurance and no lapse in coverage has occurred, the premiums are returned to the borrower in full.

Lender-placed insurance policies are generally obtained through private insurers, not from the NFIP's forced placed program, the Mortgage Portfolio Protection Program (MPPP). This is because the MPPP policy is effective on the date the application is completed and the premium is paid. Because NFIRA prohibits lenders from force-placing insurance for 45 days from borrower notification, there is generally a 30-day gap in insurance coverage under the MPPP. Conversely, private lender-placed policies are effective as of the expiration date of the policy and thus eliminate this gap. We believe that part of FEMA's stated concern over their retention rate is due to this factor. FEMA loses almost every lender-placed policy to the private insurance market.

In addition to the regular monitoring mentioned above, servicers also perform periodic review to make sure, for example, that properties with high risk A and V flood designations (that is, SFHA designations) are covered by insurance. If specific investors require additional monitoring, as is the case with Fannie Mae and Freddie, that is performed as well.

Opposition to Expanding the Triggering Events/Requiring On-going Map Monitoring

Servicers vigorously comply with the law to ensure that flood insurance when required at the time of origination does not lapse or get cancelled after closing. Unfortunately, discussion has surfaced once again about requiring on-going monitoring of all loans that are not in SFHA's at origination to determine if they later get remapped into an SFHA. If the law is expanded to require on-going map monitoring or adds remapping as a triggering event for the mandatory purchase requirement, residential and commercial lenders will face increased administrative, liability, and enforcement issues.

Collectively, the top five commercial servicers service over 120,000 loans, residential loan servicers service over 52 million loans.[13] If on-going map monitoring is required, the servicer will be required to review each loan and every insurance policy on existing mortgages that may be in an affected (remapped) area to ensure compliance with the legislation. There is a heavy administrative cost associated with this

[13] MBA Research Department.

type of review and, when coupled with the potential increase in penalties imposed on lenders/servicers that do not enforce the legislation, the requirement is unduly burdensome.

In addition, on existing mortgages, there may be issues with increased contract liability and the servicer's right to enforce the revised floodplains or mandatory insurance requirements. As soon as the requirement would become law, the lender/servicer becomes subject to contractual liability, based on its relationship with investors and other transactional parties, for nonenforcement of revisions to the legislation. At the same time, the servicer may not be able to enforce the revisions with borrowers based on their contractual language. For example, some commercial loan contracts do not permit the servicer to add insurance coverage that was not contemplated originally. This very issue prompted several lawsuits after September 11, with respect to terrorism insurance. This creates a gap between what the servicer can contractually obtain from the borrower and what the servicer is statutorily obligated to do.

MBA opposes any requirement that would expand the current triggering events for the mandatory purchase requirement from the making, increasing, extending, and renewing of a loan. Otherwise stated, we oppose expanding the triggering events to include publication of a map revision and we oppose on-going map monitoring.

Potential Reforms

We believe there are several reforms that NFIP should consider that will help increase its market penetration and revenues. These recommendations are based on the existing statutes and presume no increase in the scope of coverage of the law. Of course, each one of these suggestions carries some level of risk and potential costs that must be weighed by the benefits of additional premium income. We would like to address each one in turn:

- *Provide Additional Funding for Map Modernization*—It is crucial for the NFIP to have the most up-to-date maps to mitigate hazards and more completely determine the risks to homeowners and property owners. Every year, flooding occurs in areas outside of designated floodplains. The Federal Government should to ensure sufficient funding for this activity.
- *Consider Increasing Deductibles*—Under the current program, the lowest deductible for structures and contents is $500, and we believe this could be increased to $1,000 for single-family residential and up to 5 percent for five or more unit multifamily properties. Increasing the minimum deductible could have many positive effects. First, it would help to increase capacity to write additional insurance. Second, by increasing the share of the risk that the policyholder assumes, there would be a greater incentive for the policyholder to engage in mitigation efforts. Third, higher deductibles would help keep premiums more affordable.
- *Reclassify Multifamily Properties*—Increase the maximum structural coverage for multifamily properties (apartment buildings) to $500,000 adjusted annually for inflation and increase the maximum content coverage to $500,000, also adjusted for inflation.
- *Increase Coverage Limits*—Increase maximum residential coverage from $250,000 to a level based on the rate of inflation since 1994. Increase the content coverage from $100,000 for residential to a level more consistent with inflation. The NFIP maximum limits have not been increased since 1994, yet labor and materials costs have increased significantly since that time.
- *Consider Creating a "Deluxe" Flood Insurance Policy*—For an extra premium, the policy could include the following optional features: (1) alternative living expense coverage, set at a percentage of the structure limits, including lost rental income for residential, commercial, and multifamily rental properties; (2) mortgage assistance payments; (3) replacement cost coverage for personal property; and (4) basement coverage. Some consumers believe that the current flood policy does not provide meaningful coverage. The policy would also cover losses associated when civil authority declarations that prevent the use or occupancy of a property even though it may have not been directly impacted by flooding.
- *Inclusion of Deadlines for FEMA Responsibilities under 2004 Reform Act*—This includes the appeals process; minimum training and education requirement; mitigation programs and a report to Congress on the implementation on the 2004 reform bill.

Conclusion

There is clearly no easy recipe to ensure the NFIP brings in sufficient premiums to cover the Federal outlay of funds used to pay claims without affecting a home or business owner in another part of the country. But there are clearly things that can be done and should be done to improve the program, including increasing maximum policy coverage. As a representative of the mortgage industry, I also want to assure you that lenders take very seriously their compliance with the flood laws and do what is in our power to ensure compliance. As a result, we would oppose increased sanctions on the industry or expanding lender obligations. In sum, MBA believes it is crucial that Congress move quickly to increase the borrowing authority in order for the program to continue to meet its obligations to current policy holders and claimants in the affected Gulf Region.

Thank you for allowing MBA the opportunity to share the industry's views with the Committee.

PREPARED STATEMENT OF J. ROBERT HUNTER

DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

FEBRUARY 2, 2006

Mr. Chairman and Members of the Committee, I appreciate the invitation to appear before you today to discuss current issues regarding the National Flood Insurance Program. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America. CFA is a nonprofit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy, and education. I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. As Administrator, I ran the National Flood Insurance Program (NFIP) in the 1970's.

I love the National Flood Insurance Program. I poured 10 years of my life into getting it started. If it worked as Congress intended it to work, it would bless the Nation by making sure new building in areas prone to flooding was wise and provide coverage to all Americans exposed to high flood hazard. The program would not allow unwise construction in the highest risk velocity (or V) zones and would require elevations to the true 100-year flood line, at least in the other high-risk (A) zones.

I say this as background because I must sadly raise the question of whether the flood insurance program should be ended. If the program encourages unwise construction in floodplains, it is a danger to the Nation rather than a blessing. If the program lures people into floodplains, if it subsidizes construction in unsafe places, if it cannot stop communities that defy the program's mitigation requirements, if it falsely assures people that they are in a low-risk area that does not need flood insurance, then it must be reformed to keep the promises of safer construction made to the taxpayers when the program was begun or it must be abolished.

I also love New Orleans, my birthplace. I have been a strong advocate for the poor. My heart is broken by the situation facing many low-income residents of New Orleans. However, we cannot afford to ignore unwise construction or reconstruction in New Orleans. News reports indicate that the city may be allowing people with damage to their homes in excess of 50 percent to rebuild without elevating their homes to the 100-year level, in wholesale violation of the requirements of the NFIP.[1] It is not doing lower-income residents in high-risk areas a favor to let them build the same way as before Katrina. This is just setting them up for destruction by the next flood.

FEMA must not allow sympathy for beleaguered New Orleans residents to stop it from doing what is necessary to allow the NFIP to survive. The program must be enforced if the program is to work. I support helping the residents with direct aid, if necessary, to rebuild properly or move to higher ground. But we cannot afford, as a Nation, to allow rebuilding in high-risk areas without proper first-floor elevation. If Congress allows this, how could the 50 percent rule be enforced ever again? If a flood hits in Ohio, how could the 50 percent rule be enforced there, but not in New Orleans? To allow the wholesale violation of rules in New Orleans will destroy the NFIP. FEMA must suspend New Orleans from the program if it does not comply with the program's standards.

The program should also be terminated if the maps are not kept current. The antiquated maps in use right now are a disgrace. When I was Administrator of this program, we had a goal of updating the maps every 3 to 5 years. Even at that fairly frequent rate, I was considering adding freeboard (extra height over the 100-year level) because development drives up surface elevations. It is like sitting in a bathtub in which the water goes up as you sit down. If you put on weight, the water

[1] Jeffrey Meitrodt, "Permit Appeals Pay Off for N.O. Residents; FEMA concerned about city's leniency," *The Times-Picayune,* January 15, 2006.

level goes higher. New development is like putting on weight. Lots of development drives the water level much higher.

Consider Hancock County, Mississippi. There are 76 different maps covering most of that county on FEMA's webpage. These maps, called "Hurricane Katrina Surge Inundation and Advisory Base Flood Elevation Maps," are a "smoking gun" that demonstrates how FEMA's lack of action contributed to the destruction and loss of life caused by Hurricane Katrina. They show that the antiquated 100-year flood levels are woefully out of date and extremely low.

Consider map MS–E8.[2] In this area, Katrina's surge was 23 to 24 feet above sea level. The current map required structures to be built at 14 to 19 feet above sea level at the waterfront and 11 to 13 feet elsewhere in the county, but the revised suggested elevations are 20 to 30 feet throughout the entire area. Thus a person who just prior to Katrina built to FEMA's standard, was building about 10 feet below the real 100-year risk. This was a disaster waiting to happen because of FEMA's incompetence.

Consider map MS–G8.[3] Here, a person complying with FEMA's 100-year map just before the hurricane hit would have elevated to between 9 and 11 feet above sea level. The real 100-year risk was at 18 to 27 feet. Katrina came in with elevations of 19 to 24 feet, so people were building 10 feet or more below the real risk level. On average, the V zones in the entire county were 12 feet too low when comparing current maps with the new proposals. For A zones, the average shortfall was 13 feet. These old maps are a tragedy for the Nation. People all over the country are building what they think are safe homes but, to varying degrees, are not. They are in peril.

Taxpayers are subsidizing unwise construction as a result of these bad maps. Actuarial rates are predicated upon the maps and if they are too low, huge Federal taxpayer subsidies of unwise construction occur. Further, large areas that appeared to be outside of the special flood hazard area should actually be in the high-hazard area. People who should have been warned that their homes were in high-risk areas were not warned and many of these, who had mortgage commitments over the past two decades or more, would have been required to purchase insurance had the maps been up to date. In Hancock County, for example, a lot more people would have had flood insurance when Katrina hit. If maps are not quickly brought up to date and kept that way, the program should be terminated.

Other NFIP Issues in the Wake of Katrina

As I told you when I last addressed the Committee, I have several ideas for your consideration on some of the key questions that this tragic hurricane raises:

Long-Term Solvency

Obviously, Congress cannot decide not to pay legitimate claims to those persons holding flood insurance policies. These policies have the full faith and credit of the country behind them. But Katrina and the other storms, with payouts well over $20 billion, raise the question of how best to make sure the program works in ways that do not bust the Federal budget in the future and indeed minimize taxpayer exposure. In this context, the subsidy of existing structures is an important consideration. When the flood insurance program began, it was assumed that existing structures would, over time, be "washed out" (literally or figuratively) from the program. But many subsidized structures remain in the program.

I believe that the time has come to find ways to lower the subsidy over the relatively short-term. I submit the following ideas for your consideration:

- A 500-year mitigation and purchase requirement, rather than the current 100-year standard, would mean no subsidies in the areas that have experienced storms between 100-year and 500-year storm levels.
- Subsidies should be immediately ended on structures with market values in excess of some significant amount (for instance $500,000).
- Subsidies should be eliminated on all additional homes for an insured with more than one home.
- Subsidies should be phased out over a certain number of years (perhaps 10) on all structures with market values greater than, for example, $250,000 but less than $500,000.
- Subsidies should be eliminated on all structures that have experienced more than one flood with over $5,000 in program losses in the past.

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[2] *http://www.fema.gov/hazards/floods/recoverydata/maps/katrina*__ms__topo-e8.pdf. *http://www.fema.gov/hazards/floods/recoverydata/maps/katrina*__ms-e8.pdf.

[3] *http://www.fema.gov/hazards/floods/recoverydata/maps/katrina*__ms__topo-g8.pdf. *http://www.fema.gov/hazards/floods/recoverydata/maps/katrina*__ms-g8.pdf.

- Subsidies should be reduced for homes with market values under $250,000 each time the home is sold. This should be done in increments that will eliminate the subsidy over three sales of the structure. Persons who have received flood insurance claims payments or flood disaster relief should not get a subsidy when purchasing a new home.

I must again raise the question of why private insurers cannot assume a greater role in writing flood insurance? The original reason insurers objected to a private role when the National Academy of Sciences (NAS) conducted a feasibility study was that they said they could not price policies to avoid adverse selection—attracting properties that were extremely likely to be flooded. This concern could be resolved today by using technology to better assess risk and by requiring purchase of the coverage (perhaps up to the 500-year storm level) to assure the spread of risk. Congress should explore a long-term program to shift flood insurance back into the private sector where political pressures to bring rates below the actuarial level will not be present.

However, if the program is to remain a fully Federal one, then why continue the Write Your Own Program (WYO)? It appears to be terribly expensive[4] and has not accomplished what insurers said it would (that is, increasing market penetration of flood insurance). It results in wind/water claims adjustment conflicts of interest that could be avoided by using competitively bid contractors.

I continue to urge this Committee to immediately request a GAO study of the efficiency of the WYO program compared to those of competitively bid contractors. Such a study would likely show that the costs of the WYO program are too high, use of contractors should be expanded and the WYO contracts should be renegotiated to save significant taxpayer cost. At the very least, the payment of commission dollars to insurers who do not use commissions (such as USAA) should stop. Why should taxpayers pay agent commissions when no agent receives such commissions? Further, consideration should be given to having FEMA set only the part of the rate that covers the risk and let the WYO insurers add their own percentage loading for their costs, subject to a maximum load of, say, 25 percent.

Coverage levels should also be variable, at the consumer's option. The use of a higher deductible policy with a lower premium is one option that should exist. Policyholders could also be permitted to raise the $250,000 cap on coverage, but only at full actuarial prices, even for currently subsidized structures.

The 100-year storm standard for the elevation of new structures and the purchase requirement within that area should be revisited. Requiring coverage up to the 500-year storm for the Nation would result in greater spread of risk, fewer surprises when storms occur and greater market penetration. The price for flood insurance outside the 100-year area would be very reasonable.

A very serious concern is the low market penetration that the flood insurance program has achieved. Over 2 million homes were insured in the 1970's when I left the program. In 2004, there were only 4.4 million, about double the 1970's level. In less than 10 years, we sold what it took an additional 15 years to match despite amazing population growth along the coasts and lender requirements to purchase insurance in the high flood hazard zones. Something is wrong.

One of the rationales for allowing insurers back into the NFIP was that they would achieve greater market penetration. They have failed to do a very good job other than to receive costly reimbursement for their servicing of policies. Further, the success of the lenders in requiring coverage on properties receiving new loans in flood prone areas is questionable and also needs to be studied. Are lenders failing to follow through to keep homes covered after they are purchased? I am aware that many lenders do have tracking programs to assure continuous coverage. However, questions persist because of the continued low penetration of flood coverage 35 years after the founding of the program. Better market penetration will help assure NFIP solvency.

Consideration should also be given to increasing the amount of mandatory coverage in at least the 100-year flood risk zone. Flood after flood shows market penetration of 10 to 20 percent. This is a serious problem. What is the "hook" for expand-

[4] The Committee should ask for this information from FEMA to determine the program's actual cost. I suggest not only looking at the costs of service compared to that of a competitively bid contractor but also to compare the cost to that of private insurers selling homeowners insurance (a more complex product than flood insurance and more costly to produce since homeowners insurance is not simply added to a policy as WYO flood insurance is). In 2004, underwriting expenses for the homeowners line were 28.4 percent of written premium, of which commissions were 13.0 percent and State taxes were 2.6 percent—so that the comparable figure for servicing to compare to flood insurance is 12.8 percent (28.4 percent -{13.0 percent + 2.6 percent}). Source: Best's Aggregates & Averages, 2005 Edition.

ing mandatory coverage beyond the purchase requirement on federally backed mortgages, which appears not to work very well all by itself? This is a tough question, but an answer must be found. Perhaps non-Federal lenders could be required by States to get flood cover on high-risk homes. As an incentive, Federal benefits for floodplain management programs in participating States could be increased in those States that required their banks to require flood insurance coverage. A review of Federal benefit programs in high-risk flood areas might reveal other ways to obtain greater mandates on structures/inhabitants in the floodplains. Also, communities could, as part of their flood management requirements to qualify for the NFIP, demand covenants on the sale of properties in floodplains stipulating that flood insurance must be carried in the future. I am not expert in these matters, but it is clear that experts on Federal benefit programs and real estate should help find the answer to this vital question of expanding coverage in high-risk areas.

I have always thought that some of the burden for obtaining coverage for new structures should fall on the builders of these structures. Consideration should be given to requiring builders of new homes to purchase a 30-year (or at least a 5 or 10-year) policy. There are many advantages to this idea, including an immediate infusion of higher premiums into the program; but most important is the mitigation effect that such a requirement will have. Consider the difference in purchase price of two identical homes with builder-purchased flood coverage if one is built in harm's way the other is not. It will not take long for contractors to learn not to build in high-risk areas if they cannot market the high-risk homes.

There should also be verification by a GAO audit that participating communities forbid building in floodways and other V zones, such as storm surge areas. GAO should study the actual development that has taken place after the Flood Insurance Rate Maps (FIRM's) were put in place in participating communities to see how the development conforms to the requirements of the FIRM's. If mitigation is not working, costs will go up and people will be killed. Mitigation failures must be fixed or the program will just encourage unwise construction into the future. Finally, the legislation to reduce losses to repetitively flooded properties passed by Congress last year should be a significant help in controlling costs.

In summary, the NFIP collects too little money to cover losses over the long haul. It now collects only enough to pay for relatively normal flooding in a year, with no long-term build up of reserves to cover larger than normal loss years. Katrina is but one example of this shortfall. But even bigger flooding events than Katrina are possible and, over the long-term, certain. Category 5 hurricane storm surges at high tide hitting Miami Beach or New York City and Long Island are examples of much larger potential flooding events. Stated simply, for the program to be actuarially sound, actuarially sound rates must be charged.

There are other steps beyond raising rates that should be taken to save money for the program, such as eliminating the excessive WYO expense charges for immediate savings and making sure that mitigation is fully enforced for longer-term savings. While these are necessary steps to bring the program into actuarial soundness, they are not sufficient. Only moving over time to full actuarial rates for all properties can achieve that.

WYO Conflicts of Interest: Wind v. Water

Since Hurricane Katrina devastated the Gulf Coast, there has been much public discussion about whether damage to homes was caused by wind and rain, or by flooding. Many policyholders have policies covering wind and rain damage (under homeowners' policies), but not flooding, which is a separate policy underwritten by NFIP. Many court challenges to the industry's no coverage determinations have begun.

The importance of this legal dispute to the flood insurance program is obvious. To the extent that insurers underpay wind when allocating damage between their homeowners' policy and the NFIP policy, taxpayers will suffer. It is also true that the more lax the Federal Government is in demanding that the allocation be fair to taxpayers, the more likely it is that persons without flood insurance will receive unfair or no compensation under their wind policies. Take the situation of two damaged homes next to each other, one with flood coverage and one without. If the Federal Government is vigilant regarding the home with flood coverage and the resulting allocation is 50/50 versus the insurer suggestion of 25 percent wind/75 percent flood, the insurer will be hard-pressed to assess the similarly damaged home next door at 25 percent wind damage.

For the benefit of taxpayers and those with no flood insurance, it is essential that the Government assure a fair and proper allocation of the wind/flood damage by the WYO insurance companies who have a serious conflict of interest. CFA urges this Committee to insure that the GAO audits these allocations starting right now, so that any tendency of the insurers to diminish their wind losses for their own benefit is stopped quickly.

Conclusion

There are two crucial steps that must be taken to make the NFIP work properly. The first is making sure that mitigation works so taxpayers can realize the program's promise of reduced taxpayer exposure in the future. The second is moving to actuarial soundness.

I never thought I would utter the words that consideration must be given to ending this beautifully designed but hopelessly administered National Flood Insurance Program. However, repeal of the NFIP should be considered only as a last resort if the integrity of the program is not restored. This means bringing the program back quickly to its promise of covering all high-risk homes and businesses, eliminating unwise construction in the Nation's floodplains and taking steps to ultimately achieve full actuarial soundness. This time, however, there must be tight oversight of FEMA's implementation of the program to achieve these vital goals.

PREPARED STATEMENT OF DAVID PRESSLY

PRESIDENT, NATIONAL ASSOCIATION OF HOMEBUILDERS

FEBRUARY 2, 2006

Chairman Shelby, Ranking Member Sarbanes and Members of the Senate Banking, Housing, and Urban Affairs Committee, I am pleased to appear before you today on behalf of the National Association of Homebuilders (NAHB) to share our views concerning efforts to reform the National Flood Insurance Program (NFIP). We appreciate the invitation to appear before the Committee on this important issue.

My name is David Pressly and I am the 2006 President of NAHB and President of Pressly Development Company, Inc. of Statesville, North Carolina. I am a homebuilder with more than 25 years of experience constructing single-family homes and apartments and light commercial projects in the Statesville area.

Mr. Chairman, NAHB represents more than 225,000 member firms involved in homebuilding, remodeling, multifamily construction, property management, housing finance, building product manufacturing, and other aspects of residential and light commercial construction. 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 homebuyers and homeowners the opportunity to live in a home of their choice in a location of their choice, even when the home lies within a floodplain. The homebuilding 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 choices American consumers make when they are buying homes are some of the most critical aspects of the homebuying process. Through decisions about where to live, where to shop and how to get around town, consumers apply the power of the marketplace to shape the Nation's communities. The NFIP, by enabling the choice of purchasing a home in a floodplain, allows consumer preferences to shape towns and cities into communities that maximize quality of life and economic development.

Without the NFIP, many communities would be unable to provide affordable housing to many of their citizens. Despite a decade of unprecedented prosperity, many communities are seeing a growing gap between the supply and demand for housing. Families across the economic spectrum are finding it increasingly difficult to find a home that meets their needs. One of the leading causes of the housing affordability problem is the shortage of buildable land. By guaranteeing affordable flood insurance, the NFIP allows communities to use land that would otherwise be too costly due to high flood insurance premiums. Through the NFIP, flood insurance policies remain available and affordable and residential structures can be constructed in floodplains as long as they are built to withstand flooding. Therefore, the NFIP provides the means by which communities can address housing needs by making homeownership in areas prone to flooding safe, affordable, and practical.

The NFIP provides flood insurance to more than 4.8 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—more than 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 support efforts 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 that 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. Therefore, NAHB supports several reforms that we feel can be achieved quickly and provide needed reform to the overall program. As part of a coalition of interested industry trade groups, NAHB has publicly forwarded a list of consensus NFIP program reforms that can be implemented immediately. However, NAHB has strong reservations on several additional reforms that have been put forward in this debate, namely the proposals to expand the regulated floodplain beyond the current 100-year standard, and mandating coverage for those sited behind flood protection structures within the 100-year floodplain. While these reforms may be feasible, NAHB believes that adoption of such reforms without proper documentation that quantifies the risks, hazards, and costs of such reforms would be premature at this time.

Allow me to expand on these general themes further.

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. Unfortunately, a key tool in the NFIP's implementation, the Flood Insurance Rate maps (FIRM's), have been recognized by Congress to be inaccurate and out-of-date. Through the strong leadership of this Committee, FEMA is in the midst of a multiyear map modernization effort aimed at digitizing, updating, and modernizing the Nation's aging flood maps. The first of these updated maps is just now being rolled out, and in some areas there are large discrepancies between what was mapped as the 100-year floodplain decades ago and what the 100-year floodplain is today. Clearly, this information will help to ensure better and more informed decisionmaking. Accordingly, thoughtful consideration of the overall effectiveness of the NFIP, including those provisions relating to mandatory flood insurance purchase, can only come after the critically important FIRM's are modernized, updated, accepted, and reflected upon.

Increases to Premiums and Payouts

In an attempt to improve both the solvency of the program and its attractiveness to potential policyholders, NAHB supports a number of reforms designed to allow FEMA and the NFIP to better adapt to changes to risk, inflation, and the marketplace. Providing FEMA the authority to allow for slightly higher annual premium increases, to a maximum of 15 percent, for example, would allow the agency to reduce its indebtedness to the Federal Treasury. 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. Similarly, creation of a more expansive "deluxe" flood insurance option, or a menu of insurance options from which policyholders 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.

Mandatory Flood Insurance Purchase Requirements

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 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. For this reason, NAHB recommends that FEMA conduct a study of the feasibility and implications of such a change in the NFIP's mandatory purchase requirements prior to enacting any changes. Likewise we applaud FEMA for recognizing the need for such a study, as reflected in testimony delivered to this Committee on January 25, 2006.

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.

Revision of the SFHA Standard has Broad Implications

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 .2 percent annual chance) standard would not only require more homeowners to purchase flood insurance, but would also impose mandatory construction requirements on a whole 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 noncompliant 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 makes 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 percent standard would need to change.

Although a revision of the 1 percent 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.

Required Purchase Behind Flood Control Structures must Reflect Reduced Risk

One 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 percent 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.

Building Requirements Must Remain Tied to the 1 Percent Standard

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 homebuilders, but on the Nation's homebuyers. NAHB urges Congress to soften the impact of any programmatic changes to the NFIP by ensuring that construction requirements remain tied to the 1 percent standard.

Conclusion

Mr. Chairman, thank you for this opportunity to share the views of the National Association of Homebuilders 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 homebuilding 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.

PREPARED STATEMENT OF PAUL J. GESSING

DIRECTOR OF GOVERNMENT AFFAIRS, NATIONAL TAXPAYERS UNION

FEBRUARY 2, 2006

Chairman Shelby, Ranking Member Sarbanes, and distinguished Members of the Committee, thank you for holding these important hearings today. My name is Paul Gessing. I am Director of Government Affairs with the National Taxpayers Union (NTU), America's oldest and largest grassroots taxpayer lobbying organization with 350,000 members nationwide (you can learn more about NTU—and our educational affiliate, the National Taxpayers Union Foundation—on our website: *www.ntu.org*). I would also note that my organization works closely with the group Taxpayers for

Common Sense, and that I am here to testify not only on behalf of my own organization, but also on behalf of Taxpayers for Common Sense, and their Vice President of Programs Steve Ellis who could not attend today.

I come here to offer testimony regarding what we believe to be some rather significant problems with the National Flood Insurance Program (NFIP) as they relate to taxpayers, to illustrate to the Committee why many of these taxpayer concerns also have a direct impact on those who living in flood-prone areas, and last, to outline the need for bold steps on the part of Congress to ensure that the next major hurricane or flood inflicts less of a toll, both in the form of human suffering and lost economic productivity and taxpayer money. Although the original intent of the existing Federal flood insurance program was to mitigate many of these problems, it has not done so and as such must be considered a failure.

The recent spate of hurricanes may have been unique in recent history for their intensity and frequency, but they are perfectly normal in costing Federal taxpayers billions of dollars. Worse, there is wide agreement in the scientific community that the trend of increasing intensity and numbers of hurricanes will continue for several years. Even before these hurricanes, the NFIP had repeatedly relied on the U.S. Treasury to supplement its premium revenues.

Last week, several of those testifying on NFIP stated that from 1986 through 2004, NFIP was self-supporting. I would argue that those statements are in error. First of all, how can you bookend a program like that? Starting in 1986, the program shifted from direct appropriations to the current system in which the program borrows from the Treasury and repays its debt with interest. (By the way, it must be noted that NFIP was forgiven well over a billion in debt at that time). Then over the 18-year period in question, the NFIP borrowed when it needed to and repaid with interest, but the simple fact that it was able to borrow shows that it is not self-supporting or even actuarially sound. There is no catastrophic reserve because the program has the Federal taxpayer to fall back on.

In the aftermath of the 2005 hurricane season, the program will be forced to borrow an astonishing $24 billion from the Treasury. It's time to face facts: With premium payments yielding $2 billion per year and flooding likely to continue, even if not at the level we have seen in recent years, there is little likelihood of taxpayers ever recouping much of the $24 billion they are now owed. Thus, as Chairman Shelby said in his opening remarks at last week's hearing, the NFIP is bankrupt. As taxpayer advocates, what we must do now is work to ensure that the NFIP no longer serves as a fiscal black hole into which taxpayer dollars continually go, never to be seen again.

Prior to the NFIP's existence, insurance coverage for flood losses was not provided by any private insurance carriers. Insurance losses stemming from flood damage were largely the responsibility of the property owner, although the consequences were sometimes mitigated through provisions for disaster aid. Today, owners of property in floodplains sometimes receive disaster aid *AND* payment for insured losses, which in many ways negates the original intent of the NFIP (that being to encourage property owners to pay some of the upfront costs of expected disasters, rather than forcing taxpayers to foot the bill after the fact).[1] These policy decisions have contributed to an escalation in losses stemming from floods in recent years, both in terms of property and life.

Also, although this is not of primary importance to taxpayers, I must point out that subsidizing insurance in high-risk areas takes a significant environmental toll. Coastal areas are often among the most ecologically sensitive and diverse. Thus, it is disconcerting to know that while they spend untold billions of dollars annually on an array of environmental mitigation efforts, and often see their land's usefulness decline under Federal mandates (also created for the purpose of environmental mitigation), taxpayers would then be forced to pay once again—this time for a program that actually *encourages* the destruction of environmentally sensitive areas.

The final areas of concern taxpayers have about this program are those involving fairness and moral hazard. Specifically, I would like to bring to your attention and submit for the record a story conducted by John Stossel of ABC News. In 2003, in the wake of Hurricane Isabel, Mr. Stossel did a story called *Taxpayers Get Soaked by Government's Flood Insurance.* In this piece, Stossel recounted his own personal experience of purchasing beachfront property on Long Island, New York and constructing a house there in 1980. Stossel noted, among other things, that the most he ever paid was a few hundred dollars for insurance that actuaries say should realistically have been priced at thousands of dollars.

[1] First American Flood Data Services, "Frequently Asked Questions," *http://fafds.floodcert.com/faqs/.*

John Stossel is not the only well-heeled individual taking advantage of taxpayer-subsidized flood insurance. According to a 2000 report done by *The Philadelphia Inquirer,* six of 10 NFIP insured properties are in beach towns and, since the program does not differentiate between primary residences and vacation homes, the program's mission could be said to include ensuring that wealthy Americans are protected from floods by the full faith and credit of the U.S. taxpayer.[2]

Asking U.S. taxpayers to spend billions annually on government programs and revenue transfers designed with the purpose of assisting poor and lower-income Americans is one thing; but asking them to spend additional billions on the NFIP, which is more of a taxpayer-financed "safety net" for millionaires, is yet another. It is after all predominantly wealthy people with enough disposable income to own beachfront property who choose to live or have a second home in risky areas. Then, because it is priced far below market value, flood insurance proves even more attractive to wealthy homeowners who know a good deal when they see it. Thus, the wealthy snap up coverage while the poor are often left unprotected when disaster strikes.

To continue with John Stossel's story, as it turns out—despite beach replenishment efforts by the Army Corps of Engineers (again taxpayer-financed)—his house was washed completely away in a storm that he described as "fairly ordinary." Of course, the NFIP paid for the house (the first $250,000 of which is insured under the Federal program) and its contents (insured to $100,000) and there were only minimal restrictions prohibiting him from rebuilding on the same piece of land. Worse, he pays the same price for insurance the day after the storm as the day before. Quite simply, this is ridiculous policy. We have clear results that a location is at great risk for loss and yet we do not restrict reconstruction and we charge the same rate. I certainly cannot think of anyone who would run a business that way; no wonder we are in the hole.

It is said that the road to hell is paved with good intentions, and like all government programs, NFIP was created with good intentions in mind. To this day, many of the program's supporters believe that the NFIP actually saves taxpayer dollars because with insurance, taxpayers receive at least some compensation before the disaster strikes whereas they are never compensated for disaster relief. Even had it been well-planned and executed effectively, the Federal flood insurance program has had other unintended consequences.

Rather than simply compensating homeowners for losses, the cheap insurance has actually encouraged more people to build in flood prone areas. Last week, David Maurstad testified that NFIP insured more than $800 billion in assets on 4.8 million policies.[3] Back in fiscal year 2002, that number was "only" $644 billion on 4.5 million policies.[4] That's a 24 percent increase in insured assets on just more than a 6.5 percent increase in policies. Sure, the housing sector has been strong nationwide, but clearly there is a taxpayer-subsidized building boom going on at our Nation's shorelines, as increasing numbers of wealthy people build their "castles" on the sand.

So, what do we do now? As in a twelve-step program, the first part of solving a problem is recognizing that you do in fact have one. The recent spate of hurricanes has only exposed what experts and taxpayers have known for a long time: Federal meddling in the marketplace inevitably results in subsidies for some and significant costs for all taxpayers. Congress must act now to restore some semblance of a marketplace for flood insurance that provides adequate taxpayer protections or it must be willing to abandon the program entirely, leaving the responsibility of finding adequate insurance in the hands of individuals and insurance companies.

If nothing else, at a bare minimum, Congress must consider taking action to address the subsidies inherent in the 25 percent of NFIP's covered properties that preflood insurance rate map (FIRM). NFIP has been in effect for nearly 40 years. That is far longer than even the longest mortgage. Surely, it is time to stop paying massive subsidies to the shrinking group of unaware pre-FIRM homeowners. Other reform measures lawmakers might consider would be: Collecting actuarially sound rates that finance expected annual payments as well as a catastrophic reserve; increasing program participation through greater enforcement and by expanding the floodplain areas requiring coverage; and, increasing the use of disaster relief funds

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[2] Gilbert Gaul and Anthony Wood, "A Flawed Program Facilitates Building in Hazardous Areas," *The Philadelphia Inquirer,* March 7, 2000, *http://marine.rutgers.edu/mrs/education/coast08.htm.*

[3] David Maurstad, "Testimony before the Banking, Housing, and Urban Affairs Committee of the United States Senate," January 25, 2006, *http://banking.senate.gov/*__files/ACF43B7.pdf.

[4] Federal Emergency Management Agency, "Total Policies in Force by Fiscal Year,"*http://www.fema.gov/nfip/fy04pif.shtm.*

to mitigate future damage by making communities more flood/disaster resistant (through flood-proofing, elevating, and relocating repetitively damaged properties).

Unfortunately, the fact that for all these years Congress has been unwilling to reform the NFIP in ways that adequately protect taxpayers, eliminate subsidies, and make the program actuarially sound, may serve as a clear sign that the best way to address the program's shortcomings may be to eliminate it entirely. Federal involvement in the provision of flood insurance has been, on the whole, counterproductive. Rather than discouraging development in flood-prone areas, it encourages such development; rather than protecting Americans from nature's ravages, it puts them in harm's way; and rather than saving taxpayers money, it has resulted in additional expenditures and subsidies on a massive scale. That sounds like failure to most reasonable people!

If, after the marketplace is free of Federal subsidies that have kept for-profit firms out of the business, private companies remain skeptical of the profitability of providing flood insurance, all is still not lost. That reaction may be yet another tool to reinforce the message that living in flood-prone areas is risky and that people should be forced to bear the costs of such an unwise move. Of course, it is also quite possible that some entrepreneurial company might figure out a way to reduce its risks enough to make a profit, thus creating a private flood insurance marketplace more viable than it has been in the past. I must note that although NTU and the Consumer Federation of America rarely agree on much and we certainly do not have the same philosophical approach to many issues, Bob Hunter's comments at the Committee's October hearing on flood insurance were spot on when he suggested the insurance industry might be better able to engage in the flood insurance market than they have been in the past due to the development of improved mapping technologies.[5]

Had the NFIP not been created in 1968 and were we discussing the possible creation of such a program today, in the wake of the recent hurricane season and flooding, I do not think anyone would choose to replicate the existing system. Thus, if I were sitting before you today to testify on whether or not to create the NFIP and, if so, what it should look like, I would tell you that at times during which we as a Nation are presented with difficult policy decisions, we advocate looking to the Constitution and the Founding Fathers for guidance. Thus, it is our belief that leaving flood insurance policymaking up to the states would allow for the most creative and responsible outcomes possible. State and local officials, aware of the unique needs and challenges of their own states, could design the best solutions for their particular situations.

Although this hearing is strictly about the Federal flood insurance program, as a brief aside I would like to point out that NTU and our members believe that rather than centralizing the job of flood prevention in one Federal body that receives its funding and marching orders from Washington, States, and localities should be likewise empowered to take charge of flood prevention efforts whenever possible. I point you to the example of Galveston, Texas: In the wake of the worst natural disaster in U.S. history in which approximately 6,000 Galvestonians lost their lives (the Hurricane of 2000) citizens of the city—in their desire to make sure that such a profound tragedy never happened again—took it upon themselves to prepare for the next storm. Thus, to break the force of the waves, a concrete seawall three miles long was constructed. As an additional safeguard against flooding, the entire city was raised by picking up most of the structures and filling in beneath them with sand.[6]

The entire project cost an estimated $3.5 million (or approximately $70 million in 2005 dollars based on 1913 Bureau of Labor Statistics data calculations). The county paid for the seawall through a bond issue and the Texas Legislature financed the grade elevation. Although hurricanes still threaten the Gulf of Mexico, Galveston is a far safer place to be in a hurricane than before. They also proved at a time before Americans had grown accustomed to relying so heavily on Washington, DC, that local responses to natural disasters are viable.

The emphasis on local control does not mean that there is no Federal role, especially in disaster relief. But as we saw in New Orleans, when the responsibilities of Federal, State, and local governments overlap, too often there are also massive cracks in the system through which responsibilities tend to fall. If Congress were

[5] J. Robert Hunter, Consumer Federation of America, "Testimony before the Banking, Housing, and Urban Affairs Committee of the U.S. Senate," October 18, 2005, *http://banking.senate.gov/*__files/ACFD8E.pdf.

[6] Mary G. Ramos, "After the Great Storm: Galveston's Response to the Hurricane of September 8, 2000," *Texas Almanac,* 1998–1999, *http://www.texasalmanac.com/history/highlights/storm/*.

to take a close look at the interactions among the various flood prevention, insurance, and relief tools, we believe it would discover that restoring the primary responsibility for natural disaster planning and responses to the States (with Federal agencies in a supporting role) would leave all of us—citizens, taxpayers, and policymakers alike—better off.

Thank you, Chairman Shelby for allowing NTU to testify today and for your work on this important topic. NTU and its 350,000 members stand ready to work with you in fixing or eliminating the problems associated with the National Flood Insurance Program.

abc NEWS

Taxpayers Get Soaked by Government's Flood Insurance

Disastrous Policy

Commentary
By John Stossel

Sept. 20 — - As you watch those pictures of houses under assault from Hurricane Isabel, doesn't it make you wonder: Why do people build their homes so close to the water? They must have known a hurricane might do this. Why would they take such a foolish risk?

California

Well, people take the risk, because our government encourages us to take it. I know all about this, because I did it myself.

In 1980, I bought some beachfront property on Long Island, N.Y., and built a house there. It was a big investment for me. The down payment took just about all of my savings, and I knew what can happen to people who build on the edges of oceans. But I took the risk because the government made me a promise.

An Offer Too Good to Refuse

The promise was national flood insurance. It made my house and my neighbors' homes possible. After all, no bank will give you a mortgage unless you have insurance.

Private insurance companies were reluctant to sell insurance to those of us who build on the edges of oceans, and were they to offer it, they'd charge an arm and a leg to cover the risk. But this wasn't a problem for me, because you offered to insure my house. I know you didn't do it personally, but you, as a taxpayer, are the guarantee behind federal flood insurance. Should a big storm wipe out half the coast, you'll cover our losses up to a quarter-million dollars. Thanks we appreciate it but what a dumb policy.

The subsidized insurance goes to affluent homeowners on both coasts from Malibu Beach, where movie stars live, to Kennebunkport where the Bush family has a vacation home, to Hyannisport, where the Kennedy family has a summer home, to the Hamptons, where I bought my house.

The insurance premiums were a bargain. The most I ever paid was a few hundred dollars. Federal actuaries say if the insurance were realistically priced, it would cost thousands of dollars. Why should the government guarantee water's-edge insurance? Why should the government be in this business at all?

A decade ago I spoke with James Lee Witt, who ran FEMA, the Federal Emergency Management Agency, for President Clinton. FEMA's current director is busy with this week's hurricane, but his agency's policy hasn't changed much, so let's look again at the discussion I had with Witt.

Witt told me he thinks the flood insurance saves federal tax dollars. "If this insurance wasn't there, OK, then people would be building in those areas anyway, OK? Then it would cost the American taxpayers more dollars if a disaster hit that community and destroyed it," he said.

He said it's cheaper than offering additional disaster relief.

Should We Subsidize Insurance for Drunk Drivers?

That's government logic for you. Since we always spent huge amounts of taxpayer money bailing out people with disaster relief, politicians 35 years ago said, why don't we try to recover some of that money by selling flood insurance?

As so often happens, the program had unintended consequences. The cheap insurance encouraged more people to build on the beach, so the insurance risk is now huge. Today, $645 billion in property is guaranteed by Uncle Sam.

Geologist Orrin Pilkey at Duke University says this policy is simply "stupid." Pilkey has been one of the most persistent critics of the government's policies. He says both disaster relief and federal flood insurance just encourage people to stay in harm's way.

"We've got to get around this 'sympathy at all costs' for people who are suffering from natural disasters," Pilkey said.

Witt disagreed. He said, "Should we just walk away and say, 'We're not going to help you'?"

If I were a drunken driver who kept wrecking my car, should there be federal car insurance to make sure I have cheap car insurance?

Washed Away

Witt pointed out that the government did require me to put my house on stilts. That was a good thing because 16 years ago, most of my beach just washed away. It wasn't even a hurricane, just three days of big surf and suddenly I didn't have waterfront property. I was over the water. Still, the house survived because of the stilts, and what a view I had then.

Uncle Sam didn't even raise my insurance premiums. In fact, he spent millions more of your tax dollars to rebuild my beach. Up and down the coast, the Army Corps of Engineers dumped sand on hundreds of beaches.

This seems like a dumb policy too, since a study of replenishment projects found the new sand usually washes away within five years. But the government does it anyway and you pay for it.

I asked Professor Pilkey what he thought of people like me who build houses on beaches? "I think you're a vandal and extremely costly to our society," he said.

A few years ago, I got a call from a friend. 'Happy New Year,' he said, 'your house is gone.' And it was. During a fairly ordinary storm, the ocean just dug up the sand under the pilings and took the whole house away.

There it was the next day on the front page of the newspaper. I'd always wanted to make front page news, but not like this. It was an upsetting loss for me, but financially, I made out fine. National flood insurance paid for the house and its contents. I could rebuild my house, and the government would insure me again and again. I didn't rebuild. I'd learned my lesson; I sold what was left of my land. But the outrage is that federal flood insurance exists at all. There is a quarter-million-dollar limit on each payment, and as long as I build my house in accordance with zoning laws and ordinances, there is no limit on how many times the government will pay if a house keeps washing away.

Give Me a Break.

PREPARED STATEMENT OF DAVID C. JOHN

SENIOR RESEARCH FELLOW
THOMAS A. ROE INSTITUTE FOR ECONOMIC POLICY STUDIES
THE HERITAGE FOUNDATION

FEBRUARY 2, 2006

My name is David John. I am Senior Research Fellow at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The catastrophic losses that the National Flood Insurance Program (NFIP) faces in the wake of this year's hurricane season prove that it is time for Congress to fix the program once and for all. The solution is to take steps to make NFIP actuarially sound. Such changes may not be popular among those who live in floodplains or along the coast, but they are the only responsible way to shore up the program and protect taxpayers.

According to David Maurstad, Acting Insurance Administrator for the Federal Emergency Management Agency (FEMA), claims due to Katrina and Rita could exceed $22 billion, or about one-and-a-half times the $15 billion NFIP paid out in claims between its creation in 1968 through 2004. Maurstad's estimate amounts to more than 11 times the almost $2 billion NFIP paid for flood insurance claims stemming from the hurricanes that hit Florida and other areas in 2004.

So far, Congress' reaction to these losses has rightly focused on ensuring that the program has the money to pay claims against it. In September, NFIP's authority to borrow from the Treasury was raised from $1.5 billion to $3.5 billion. November saw a further increase to $18.5 billion. Last week, Mr. Maurstad told this Committee that NFIP will need to borrow $5.6 billion more just to cover claims and expenses through the end of fiscal year 2006. Interestingly, it appears from his testimony that $670 million of the roughly $25 billion that NFIP expects to borrow from the Treasury will go back to that agency in the form of interest payments.

In theory, NFIP will repay these loans from its premium income, but if interest alone eats up almost 35 percent of NFIP's annual income of roughly $2 billion, the only way that repayment is possible will be if premium income is greatly increased and average claims remain at the pre-Katrina level. Since NFIP is expected to repay the loans, pay its administrative expenses, and meet average year losses from that $2.0 billion, realistically, the only way to get these loans off of NFIP's books will be for Congress eventually to forgive them.

Unfortunately, the demands on NFIP are not likely to decline. While losses from a single storm like Hurricane Katrina may be exceptional, scientists expect hurricane activity to build in coming years. As millions of Americans continue to relocate to flood-prone areas and property values in those areas continue to rise, NFIP can expect to face much higher levels of annual claims then it has in the past. Unless premiums income grows at least as fast, the program's request for increased borrowing authority is likely to be an annual event rather than an exception caused by a catastrophe.

Another challenge to the program's finances would develop if Congress increases the level of flood insurance coverage available on a single structure and its contents. Realistically, Congress is quite likely to do just that. Such an increase would reflect rising property values, but it is questionable if premium income on the increased insurance will cover the higher losses.

The net result of these factors is an NFIP that is a permanent borrower, and represents a constant drain on taxpayers. The only way to avoid constant deficits and increased borrowing is to reform the program. The current request for additional borrowing authority is an excellent opportunity to make substantial changes that will reduce the likelihood of continued NFIP bailouts.

Four Necessary Steps to Avoid Future Bailouts

Eliminate the current subsidy for older structures and require coverage for the replacement value of the property. The only way to avoid still more Congressional bailouts of NFIP is to make the program actuarially sound and to target it toward people who actually live or work full-time in covered structures. Today's NFIP subsidizes about one-fourth of the structures that it covers. About 76 percent of policyholders pay risk-based premiums that include the possibility of a catastrophic loss. However, structures that existed before the surrounding community joined NFIP—24 percent of the total—receive flood insurance at subsidized rates that imply a substantially lower risk of flooding than actually exists. The Government Accountability Office (GAO) estimates that some premiums are only 35 to 40 percent of what they would be without the subsidy. The total value of this subsidy is an estimated $1.3

billion annually. In addition to making NFIP's finances shaky, the subsidy discourages private insurance companies from competing with the Federal program. Finally, the program assumes that flood control measures such as levies and dikes will protect the properties near them, regardless of whether they are adequate and in good repair.

NFIP should eliminate the subsidy for older structures because its continued existence is a danger to the program. In order to minimize the impact on home and business owners, the subsidy could be phased out over several years. To some extent, the higher premiums will make it more attractive to replace older structures that are prone to higher flood losses with new buildings that incorporate architectural features that would minimize such damage.

In addition, many NFIP policies only cover the remaining balance on a structure's mortgage, not the cost of actually replacing it. This protects the lender but can leave homeowners with a ruined property that they cannot afford to rebuild. Flood insurance should also cover the cost of replacing the structure, rather than just the cost of repaying its mortgage. Although this would increase premiums, insuring for replacement value will make it more likely that homes and businesses will be able to rebuild, rather than relocate.

Require flood insurance where storm surges are possible—including areas behind a levee or other flood control measures. Currently, NFIP coverage is required only where there is a 1 percent chance of a flood and not in low-lying areas where surges are likely following major storms. A significant number of property owners affected by Hurricane Katrina suffered water damage despite the fact that their structures were outside of the 100-year floodplain where flood insurance is required by law. The most famous of these areas are the neighborhoods in New Orleans that were located behind a levee. Realistically, any flood control measure can be expected to only protect against events of a certain size. This means that there is some residual risk of flooding in areas that are behind levees, downstream of a dam, or in a coastal area that could see a major hurricane. The ability to predict where a flood will hit is more of an art than a science.

Flood insurance should be required in all areas where a flood or storm surge is likely if a weather event reaches catastrophic levels. Especially with serious hurricanes more likely to occur in the future, it makes little sense to continue to leave structures at risk of storm-surge damage or near levees that could fail outside the system. NFIP should also assess the possibility that flood control measures in an area are likely to fail or are inadequate when determining premiums. In addition to making actuarial sense, this step would help to better inform homeowners of the risk of flood damage that they actually face.

Strengthen mitigation programs to reduce repeat losses. According to GAO, structures with repeat losses represented almost a third of all claims paid between 1978 and March 2004. Roughly 2,400 structures in Alabama and Mississippi that were damaged by Hurricane Katrina had suffered losses before, as had roughly 20,000 structures in Louisiana. If a property is responsible two or more claims of over $1,000 each in 10 years, NFIP can offer to move, raise, flood-proof, or even buy the property to the reduce overall cost to the program. Unfortunately, these actions are often delayed or avoided altogether.

Congress should pressure NFIP to step up mitigation efforts by setting explicit goals for the agency and establishing regular reports by an outside agency on its progress that are examined at regular oversight hearings. In most cases, retrofitting structures to reduce flood damage will save NFIP the cost of expensive repairs and the structure's owner the disruption caused by flood damage.

Assess higher premiums for vacation homes and second homes: Currently, NFIP charges the same rates for both vacation homes and owner-occupied structures. However, the number of homes built on coastal barrier islands continues to grow very rapidly, with a significant proportion of these homes being expensive vacation homes that are rented out for most of the year. One way to raise NFIP's income would be to charge owners of these homes higher premiums. Initially, second or vacation homes could be charged 15 to 20 percent more than owner-occupied structures, but over time, this surcharge could be increased even higher. The higher cost would be largely borne by increased rental fees, while the additional money could be used for a variety of purposes, ranging from repaying the loans to the Treasury, financing additional mitigation efforts, or even slightly subsidizing the flood insurance premiums of lower income homeowners.

Conclusion

Especially in coastal areas, artificially low flood insurance premiums are subsidies that encourage people to live where natural disasters are more likely to occur. While people should be allowed to live where they please, they should also bear the risk that their choice may subject them to storms, floods, tornados, and other natural disasters. Hurricane Katrina caused what eventually will be recognized as a massive bailout of NFIP, and current weather and population trends make future bailouts likely. Rather than wait around for the next bailout, Congress should make NFIP actuarially sound. These steps necessary to this end will not be popular with many people who live in a floodplain or on the coast, but they are responsible ways to prevent pouring still more scarce tax dollars into the program.

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PREPARED STATEMENT OF PAMELA MAYER POGUE, CFM

CHAIR, STATE OF RHODE ISLAND

FEBRUARY 2, 2006

Mr. Chairman, Ranking Member Sarbanes and Committee Members, the Association of State Floodplain Managers is pleased to be part of this important discussion about ways to reform the National Flood Insurance Program (NFIP). We want to express our appreciation to you for this thoughtful examination of the program and ways to improve it. The past season of natural disasters has highlighted problems that needed to be addressed within the existing framework and has called attention to the need for creative solutions for the long-term solvency of the program.

Who We Are

The Association of State Floodplain Managers, Inc. (ASFPM), and its 22 Chapters represent over 9,000 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. Many of our members work with communities impacted by Hurricanes Katrina and Rita or work with organizations that are assisting those communities in rebuilding efforts. 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 members are designated by their governors to coordinate the National Flood Insurance Program (NFIP) and many others are involved in the administration of and participation in FEMA's mitigation programs. For more information on the Association, please visit *http://www.floods.org*.

The Challenge

Since the tragedies on the Gulf Coast, the Nation has been immersed in a discussion of how to deal with truly catastrophic events such as what happened in 2005. Clearly our policies developed and implemented through laws such as the National Flood Insurance Act and the Stafford Act, are better designed to respond to "average" loss years or to those events that may be considered large but not catastrophic. The four successive hurricanes that impacted Florida in 2004 provide an example of a difficult disaster season that could be handled within the existing program with limited Treasury borrowing, fully within the capability of the NFIP to repay. Although devastating, these storms were an entirely different order of magnitude than the combined power of Katrina, Rita, and Wilma.

It was made clear during last week's testimony before this Committee that from a policy standpoint it will be difficult to change policies so that events as catastrophic as Katrina will not challenge the financial solvency of the NFIP. However, the lengths to which policy choices are made must be balanced by what shapes our perception of reality. For example, prior to 2004 Hurricane Andrew was seen as the outlier storm—one of such magnitude that it would not happen again for some time. But, Andrew was soon replaced by the four Florida Hurricanes in 2004, only to be replaced by Katrina, Rita, and Wilma in 2005. Now, reality is that Andrew was not necessarily an outlier event; rather, it was one storm that we now see as more normal as we head into a cycle of increased number and magnitude of storms. The point is that while smaller policy changes can and should be taken, larger, more meaningful policy changes should be taken as well which will require bold action by this Congress.

Thank you for inviting us to offer our views on the solvency of the NFIP. The following testimony addresses:

A Reflection on the Relevance of the Early History of the NFIP to Changes Needed Now

Reforms to the National Flood Insurance Program

- Subsidy reduction and program changes.
- Program expansion.
- Mitigation improvements.

Broader Changes

- Catastrophic provisions.
- Coordination with and improvement of the Stafford Act.
- Development of a comprehensive and cohesive national levee policy and inventory.
- FEMA and the Department of Homeland Security.

A Reflection on the Relevance of the Early History of the NFIP to Changes Needed Now

When ASFPM provided testimony to this Committee last fall (our previous testimony can be found at *www.floods.org*), we included a lengthy discussion on the history of the NFIP. We indicated that the program was established as a "quid-pro-quo" program. Through it, relief from the impacts of flood damages in the form of federally backed flood insurance became available to citizens in participating communities contingent on flood loss reduction measures embodied in State and local floodplain management regulations. Occupants of existing structures in flood prone areas would benefit from subsidized flood insurance premiums, but occupants of new structures would have to pay actuarially based premiums. This was based on the concept that those already living in the floodplain did not understand, or know of the flood risk, but future occupants would through information provided by the NFIP—via flood studies and maps. The original program would be voluntary in terms of community participation and the purchase of flood insurance. Congress tasked the FIA to carry out studies to determine local flood hazard areas within which flood insurance provisions and appropriate land use regulations would be applied. The FIA adopted the 1 percent annual chance as a minimum national standard for floodplain management, based upon a recommendation of a special review committee of national experts that met at the University of Chicago in December 1968.

What has history taught us since Katrina? First, we found out how much risk was NOT reflected on FEMA's flood maps. This validated the importance of FEMA's Flood Map Modernization Initiative to update and modernize maps which now are often 15–30 years old advisory maps being produced now for the storm affected areas show the true 100-year floodplain as much larger than the original maps showed due to development and other factors. Beyond the 100-year floodplain, areas of coastal surge that occurred miles inland were not shown on the FEMA flood maps (which are the most common tool used by Americans to determine flood risk) as coastal flood hazard areas. We also have learned that not as many people carry flood insurance as need to. Perhaps our geographical areas of mandatory purchase are not large enough, or within these, there are too many exceptions. Nationwide, about 25 percent of flood insurance claims come from areas outside of the 100-year floodplain. We also know, from a meteorological standpoint, that from the 1950's through the 1980's we experienced a relatively calm storm period when it comes to the frequency and magnitude of hurricanes and we are now in a cycle of increased storminess.

In 1968, Congress took bold action. By creating the NFIP, they knew that property owners were impacted by floods, but did not know necessarily how many structures or how much land area was going to be included in the 1 percent chance floodplain since very few floodplains were even identified at that time. What they did know is that a mechanism such as flood insurance was a help, not a hindrance, that would help people recover more wholly than if flood insurance was not available or required. Even though we must now focus on the $23 billion cost that will now have to be paid by the U.S. Taxpayer—one might say a "tax" on those who choose not to live in hazard areas—the NFIP has been successful. It has covered over $15 billion in losses pre-Katrina. It now results in over $1.5 billion in annual avoided losses due to compliance with building and development standards. Along with FEMA's hazard mitigation programs which have invested over $4 billion, some $16 billion in avoided losses have resulted that would have otherwise been absorbed largely by the U.S. taxpayer. A recent independent study requested by the Congress and done by the National Institute of Building Sciences, has found that $4 of benefits result from every dollar invested in disaster mitigation.

Reforms to the National Flood Insurance Program

There are many reforms that can be taken now to shore up the NFIP. Last week, FEMA Mitigation Director David Maurstad identified several reforms and ASFPM is supportive of a number of them.

SUBSIDY REDUCTION AND PROGRAM IMPROVEMENTS

Providing authority to eliminate subsidies over time for Pre-FIRM properties, particularly for other than primary residences. ASFPM understands the breadth of discussion and options available when it comes to the issue of subsidy (or discount) reduction. In keeping with the original intent of the NFIP to keep rates affordable, focusing subsidy reduction on structures other than primary residences would avoid impacting those with limited incomes.

Strengthen the mandatory insurance purchase requirement for federally regulated lending institutions to require insurance to value as opposed to the outstanding bal-

ance of the loan, and for the life of the loan, to require more frequent portfolio reviews by lending regulators, and to increase the penalties for institutions that do not comply with mandatory purchase responsibilities. The strengthening of the mandatory purchase requirement has historically provided positive results. In 1973, when the mandatory purchase requirement was added (since it was not included in the original 1968 Act), the number of flood insurance policies jumped. In 1994, when lender penalties were created for noncompliance with the mandatory purchase requirement and forced placement of policies and escrow provisions were made, policies and policy retention again jumped.

Other reforms that the ASFPM believes should be implemented include:

Increasing coverage limits. ASFPM believes it is reasonable to increase coverage limits under the NFIP. With the increase in property values, it would be appropriate to increase residential coverage to $335,000 and commercial coverage to $670,000. These are the coverage levels provided in H.R. 4320, reported out of the House Financial Services Committee.

Additional funding and time for FEMA's Map Modernization program. As we have testified in the past, ASFPM is fully supportive of the Map Modernization Initiative. Because of our interest in assuring that the effort and investment produce the quality undated maps we all need and Members of Congress expect, we strongly recommend that the program be extended beyond its current 5-year life at the same level of $200 million/year.

In order to meet the program metrics requiring that a certain percent of the population have "new" maps within a certain timeframe, we are concerned that the necessary, yet time-consuming restudies of hydrology and hydraulics are not being done. Once the program was launched and needs were surveyed, it became apparent that the mapping needs are more extensive than can be addressed in a 5-year period.

Waiting period between purchase and policy effective date should remain 30 days. The waiting period was previously 15 days and was changed to avoid policy purchase with knowledge of weather forecasts and policy dropping after the danger has passed. There are proposals to reduce the waiting period, but ASFPM is concerned that this would open the program to more claims without the continuity of premium payment.

PROGRAM EXPANSION

Mapping "residual risk" and the 500-year floodplain. ASFPM understands the need to better understand the additional areas subject to flood risk. A number of Senators expressed this concern during last week's hearing on flood insurance reform. While many of the FEMA flood maps show such areas, many do not. Areas that are flood hazards but are either sporadically found or not found at all on Flood Insurance Rate Maps (FIRM's) include: 500-year floodplain (2 percent annual risk of flooding), coastal storm surge zones including those from significant hurricanes, residual risk flood zones that include areas protected by levees or floodwalls but would be flooded in the event of failure or overtopping and dam failure zones.

ASFPM strongly recommends that the Nation embark as soon as possible on a program to identify these risk areas. We support Senator Reed's bill, S. 2005, calling for mapping 500-year floodplain and incorporating U.S. Army Corps of Engineers coastal inundation maps, and NOAA storm surge and coastal erosion data, in addition to USGS streamgaging data onto FEMA Flood Insurance Rate Maps (FIRM's).

Senator Reed's bill would also reactivate the Technical Mapping Advisory Council originally established in the Flood Insurance Reform Act of 1994 with a 5-year life. Its recommendations led to the development of the Map Modernization Initiative. This is a proven, effective mechanism for involving partners and stakeholders to ensure the quality and utility of the map product. The provisions of Senator Reed's bill would provide citizens, community planners, and Members of Congress with better information for individual, community, and policy decisions. It is also important to remember that the utility of the 1 percent chance event was mandated by statute and therefore mapping these other flood risk areas is not incongruent with the intent of the NFIP.

Last week, Senator Dole voiced concern about the State of North Carolina possibly being the first to be required to expand the mandatory purchase requirement because of its national leadership in updating its flood maps. Certainly an equitable system of implementing any expansion of required flood insurance would be important.

Expansion of mandatory purchase requirements to those "residual risk" areas mapped as protected by levees or below dams. While these areas have a low probability of flooding, the hurricanes of 2005 have shown us that the losses in the event of flooding are likely to be catastrophic. Such policyholders would pay a low, preferred risk, premium rate reflecting the low probability of flooding.

Expansion of the mandatory purchase requirement to the 500-year floodplain. ASFPM believes that is good policy to provide those in the 500-year floodplain with flood insurance coverage so that they would be better protected in the event of other catastrophic or even major events. One of the lessons learned post-Katrina was that there were many flooded properties that did not have flood insurance and whose property did not fall into a 1 percent chance floodplain based on FEMA' s Flood Insurance Rate Maps (FIRM's). Such areas that are flood hazards but are either sporadically found or not found at all on FIRM's include: .2 percent or 500-year flood hazard areas, coastal storm surge zones including those from significant hurricanes, residual risk flood zones such as areas that are protected by levees or floodwalls but would be flooded in the event of failure or overtopping, and dam failure zones. All of these areas contain risk from flooding, and many of those areas could be catastrophically impacted. ASFPM maintains that extension of required coverage areas should be viewed as affording citizens important new protection.

Concern was expressed at last week's hearing over the cost of such policies since so many additional property owners would be affected. It is our belief that the rates of flood insurance policies in these areas would be reflective of the lower probability that a flood would occur and would be in line with FEMA' s current preferred risk policy or those policies for existing .2 percent chance flood zones. Those policies range from $112 to $317/year.

It is important to explain that extending the mandatory purchase of flood insurance requirement does not necessarily mean that the land use regulations that are part of NFIP in 1 percent chance floodplains have to be extended to these other areas. In fact, we would not recommend this at this time due to the lower probability of flooding in these areas. Recognizing the catastrophic nature of flooding there should it occur, however, means that flood insurance policyholders would be much better protected and costs to the taxpayer would be significantly less.

Expansion of mandatory purchase within the 100-year floodplain. The other area where the mandatory purchase requirement may be ripe for adjusting is who it affects in the 1 percent chance floodplain. Currently, it only affects those with a federally backed mortgage or mortgages from Federally regulated lenders. This leaves out mortgages from non-federally regulated institutions and those structures without mortgages. Previous studies have indicated that perhaps as many as 40 percent of mortgages come from non-federally regulated sources.

RISK REDUCTION IMPROVEMENTS

Enforced use of advisory flood maps. FEMA has worked to make available new advisory flood maps for the hurricane damaged areas. These maps reflect changes since the old paper maps were produced and newly calculated Base Flood Elevations (BFE's).

Advisory BFE's are being used somewhat successfully in the Gulf Coast as we transition into the recovery and rebuilding phase. According to testimony presented by Mr. Maurstad last week, approximately 30 percent of communities have adopted these elevations which were developed in the aftermath of the storm event, but have not gone through the official appeal and comment period, as required by rule, that accompanies the creation and adoption of updated FIRM's. Still, that leaves 70 percent of the communities in this area that have not adopted these elevations and who are rebuilding at a much higher risk of future flood damage. We have recommended before that the Committee urge FEMA to make the necessary rule changes to require these elevations be used. At the same time, we commend FEMA for tying the use of these advisory elevations to the availability of hazard mitigation funds to assist with rebuilding and urge the Committee to be supportive of FEMA' s position in the face of increased pressures to relax this standard as rebuilding gets underway in earnest.

Urge other Federal agencies to require use of advisory flood maps. Executive Order 11988 requires Federal agency coordination of disaster mitigation policies and practices. In general, there has been insufficient coordination among Federal agencies with the result that one may inadvertently undercut another's programs or one may be unnecessarily duplicative of another's. A mechanism to ensure adherence to E.O. 11988 should be developed.

Provide for additional Increased Cost of Compliance (ICC) coverage—money for NFIP policyholders to bring their structures up to existing flood-related building codes, in addition to available building limits. ASFPM has long supported the concept of ICC, but has been disappointed in its implementation. An ICC surcharge of up to $75 is associated with flood insurance premiums and, historically, large amounts have been collected while very little has been paid out. To our knowledge, this has resulted in surplus ICC funds being used to balance the large flood insurance fund. Why? Because the current interpretation of coverage under ICC is too stringent. For example, the average ICC claim, when used in conjunction with a FEMA mitigation project such as acquisition/demolition, is well-below the ICC limits because it has been interpreted that ICC will only pay for some of the demolition costs. Yet, when completed, the total acquisition/demolition project will result in the removal of an at-risk structure that is often noncompliant with local floodplain management codes. This will be a significant issue during the rebuilding of the Gulf Coast, where in Mississippi and Louisiana it is estimated that there will be about $4 billion in mitigation funds available under the Stafford Act. If ICC funds can be more flexibly utilized, they will be a significant source of non-federal matching funds and can facilitate use of the Stafford Act funds.

ASFPM wholeheartedly supports increasing the current ICC cap from $30,000 to $50,000, but we would need more information about current uses of ICC funds and a FEMA commitment to utilize ICC funds only for their intended purpose before we could support raising the surcharge cap of $75 as was proposed by FEMA last week in testimony. We also point out that the authority for ICC provides for use of ICC funds at the discretion of the FEMA Director.

We would suggest that the Committee either address the encumbrances to use ofICC legislatively or urge the FEMA Director to use the available discretionary authority to more effectively and appropriately utilize the ICC program that policy holders have paid for.

Implement the Repetitive Flood Loss programs created in FIRA 2004. The Congress has spoken decisively twice about the need to stem an annual loss to the Flood Insurance Fund of $200 million by investing in mitigation of repetitive flood loss properties.

This Committee and its counterpart House Committee developed legislation (in the Flood Insurance Reform Act of 2004) which created two new pilot programs and expanded the existing Flood Mitigation Assistance (FMA) program. FIRA 2004 provided for the transfer of $90 million from the Fund to the FMA program. The President's fiscal year 2006 budget requested only $28 million for this purpose, yet the Congress appropriated the full $90 million, clearly signaling that the program should be fully implemented. Apparently, FEMA has determined that it can only make $28 million available, because that is all that can be raised from the administrative fee income of the Flood Insurance Fund.

The report accompanying H.R. 2360, H. Rpt. 109–79, specifically provides for transfer from the Flood Insurance Fund and in one instance, specifically refers to premium income. *ASFPM urges the Committee to clarify that both fee and premium income of the Fund may be utilized to fund these mitigation programs since they are so clearly cost-effective to the Fund. The full $40 million for the existing FMA program should be transferred for use during this fiscal year. The need is dramatic. FEMA should be strongly encouraged to finalize regulations implementing the two new pilots as soon as possible given the urgent need for these programs.*

The existing FMA program includes per State caps on how much FMA money can be spent on repetitive flood losses. Naturally, those States with the most repetitive losses are at or near those caps. Since FIRA 2004 doubled regular FMA from $20 million to $40 million, ASFPM strongly recommends that the per State caps either be doubled or removed.

BROADER CHANGES

The changes below are those that ASFPM suggests should be considered by the Congress but may need more study. Not all are directly within the jurisdiction of this Committee, but all have a direct bearing on the effectiveness of the National Flood Insurance Program.

Catastrophic Provisions. While the NFIP has functioned well for the average loss year, the past season and predictions for the future raise the question of how to meet the claims needs of catastrophic losses. There have been a number of suggestions ranging from simple forgiveness of Treasury borrowing in such cases to creation of a catastrophic loss fund to providing for Federal reinsurance of some kind. ASFPM would support a Congressionally mandated study of these economic challenges and possible provisions for accommodating them. We believe that the NFIP, with modifications and improvements, can continue, in average loss years, to provide important protection for those at risk of flooding while fostering floodplain management to reduce losses. Creative thinking beyond our expertise is needed to address the challenges of catastrophic losses.

Coordination with and improvement of the Stafford Act. The programs of the Robert T. Stafford Relief and Recovery Act are an important element of recovery from and mitigation against the devastation of flood events. Its assistance programs help communities replace infrastructure and mitigate against future damages, and its hazard mitigation programs help individuals and communities protect buildings from future flood damages. However, some changes need to be made to address truly catastrophic situations which lead to the inability to pay straight salaries for local officials. Local permit officials are an especially important part of the rebuilding process. Properly rebuilt and reconstructed structures will be far more resistant to future flood damages. When local communities must layoff these officials or are unable to hire additional officials, the Stafford Act's provisions allowing only payment of overtime for such officials and not their base pay, adversely affects the long-term recovery and mitigation against future disasters.

So too, is the inability to use Stafford Act assistance for the express purpose of conducting substantial damage determinations which are required under the NFIP. Also, the availability of non-Federal matching sources of funding is extremely important because the Hazard Mitigation Grant Program (HMGP) is a formula program with a local match requirement. As mentioned earlier, ICC can be a form of non-Federal matching funds for Stafford Act mitigation programs.

Development of a comprehensive and cohesive national levee policy and inventory. The development of a comprehensive and cohesive national levee policy is also important to the success of flood mitigation programs. It is evident that the level of structural protection agreed to for the City of New Orleans, for example, will impact building guidance in areas protected by those structures. Economic factors drive these decisions, often influenced by a community understanding that a FEMA flood map can be changed to show an area behind a levee to be designated as an area of "minimal flood risk" if a levee is constructed to a 1 percent chance standard (plus freeboard). Cost drives the design of levees, yet this approach can be shortsighted and result in a race to the lowest common denominator in terms of standard of protection. An important change would be requiring purchase of flood insurance in areas behind levees and requiring their being mapped as areas with flood risk. Currently, the State of California is considering such a measure due to liability faced by the State as a result of recent lawsuits against it. In addition, though, we must find out where these areas are. At this time there does not exist an accurate inventory of levees in this Nation. Only a few States have even attempted such an inventory. Worse, there has been no comprehensive evaluation of the composition of existing levees to determine if they are engineered structures or piles of materials from a bygone era. We should know where levees are and what they are made of to make accurate estimates of risk potential of the land which they ostensibly protect from flooding. Luckily, we have a framework for such a levee program in the National Dam Safety Program. A similarly designed program for levees and floodwalls would begin to address this problem.

FEMA itself—and the Department of Homeland Security. As Congress performs its oversight functions, much effort is being made to determine how effective FEMA was in its role in responding to recent hurricanes. ASFPM has testified many times over the past few years that the primary reason FEMA's ability to respond to disaster events has diminished is its inclusion into the Department of Homeland Security.

Prior to this reorganization, FEMA did quite well dealing with both natural disasters and man-made events. Since that time, events like Isabel and Katrina have shown FEMA's reduced capability. Furthermore, FEMA oversaw a system of comprehensive emergency management in this country—one that linked and incorporated preparedness, response, recovery, and mitigation into an overall approach to how we, as a Nation, address hazards and disasters. With its incorporation into the very large new Department of Homeland Security, FEMA lost the nimbleness and direct access to the President that it had as an independent agency.

Because the central mission of the new department is, quite rightly, homeland security, FEMA and natural disaster programs were paid very little attention until the previous hurricane season. Efforts to build the new department have been challenging, certainly, but they have resulted in some of FEMA's programs being buried in other offices within DHS. A number of grants are administered from the DHS Office of State and Local Programs while their programs themselves are still within FEMA. Last year, Secretary Chertoff began further reorganization of FEMA and, as we understand, plans to continue with major changes expected shortly which could directly affect the NFIP and the relationship between its mitigation and insurance components. These reorganizations will continue to dilute the effectiveness of FEMA, our Nation's emergency management system and the NFIP.

We urge the Committee to examine the effects on the NFIP and flood loss reduction of FEMA's inclusion in DHS. We hope this Committee and the Congress will take action and make FEMA an agency that once again can respond to all hazards, can have a direct relationship between the FEMA Director and the President, can again foster effective Federal, State, and local partnerships and will put all of the pieces of emergency management together again. Currently, there are several bills that have been introduced that would more or less accomplish this.

Conclusion

As the Nation recovers from the impacts of the last 2 years, it is evident change is needed. It is has been often said that since September 11 we are a Nation changed. It appears that after Hurricane Katrina, we are again a Nation changed. This Congress faces challenges similar to those faced by the Congress in 1968. How do we make necessary changes to our framework of national policies and programs necessary to fulfill multiple missions: Protect the American public, protect taxpayers from excessive post-disaster costs, assist communities to recover from catastrophic events, and balance all of these costs? Luckily, we have a framework, through the NFIP, that we did not have in 1968. We too, have hazard mitigation programs that compliment the risk reduction measures of the NFIP. Although significant decisions need to be made, at least we have a basic program and policy to begin with.

Thank you for the opportunity to provide our thoughts on these important issues. The ASFPM and its members look forward to working with you as we move toward a common goal of reducing flood losses.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM REGINA M. LOWRIE

Q.1. What more can be done to ensure communities are complying with NFIP's development requirements in flood hazard areas?

A.1. Although this issue is not specifically in our expertise, the Mortgage Bankers Association is concerned about any effort that might prohibit lending in nonparticipating communities or communities not complying with the NFIP development requirements. Although regulated lenders and Federal agencies such as HUD and FEMA are not permitted to make loans or offer insurance, to assist building in nonparticipating communities, other private lenders and private insurers are not so restricted. Should such a homeowner be barred from every form of financing available, the result might be unmarketable properties. In other words, it could mean a complete erosion of equity and value to the homeowner who purchased the home according to preexisting laws. If this is the end result, and the Federal Government effectively eliminates housing in specific areas, the Federal Government should invoke eminent domain and pay these homeowners fair market value.

Q.2. There are differing views regarding lender compliance with mandatory purchase requirements. If lenders are not complying, would MBA be opposed to the imposition of fines and civil money penalties that are meaningful?

A.2. MBA has looked at the issue of noncompliance and have found it is not generally a willful neglect of the law, but technical errors and problems with interpretation and overly broad policies that generally do not work in the market. While a higher penalty will increase revenue to the Treasury, such penalties will not likely cure nonperformance.

For example, there is considerable confusion over the amount and timing of flood insurance on new construction. Varying policies require flood insurance at different times. The Federal statute requires that "improved real estate" be insured when it is in a Special Flood Hazard Area (SFHA) in a participating community and when it is secured by a loan from a federally regulated lender, when the loan is sold to Fannie Mae or Freddie Mac, or when it has been acquired with Federal funds. The flood insurance statute defines improved real estate as "real estate upon which a building is located." NFIP and FEMA definitions of a building include a permanent foundation, walls and a roof, implying that insurance is not required until late in the construction process. FEMA's Flood Insurance Manual (FEMA 2005), the primary source of information on flood insurance for agents, specifies that insurance is available for buildings during the course of construction, but does not indicate when such coverage should or must commence. The Federal bank regulators state that insurance must be purchased at loan origination if the building will be in a SFHA in a participating community, but also state that that insurance must be purchased to keep pace with construction (as opposed to purchasing full coverage at the time of loan origination). However, insurance agents often will not write the insurance policy until after a slab is poured and an elevation can be obtained based on actual construction of the first floor.

Another common problem is difficulties in reading the flood maps. There will always be a margin of error in reading the flood maps to determine whether the physical structure, and not just the land, is within the SFHA. Mortgage lenders are not trained to read flood maps and generally rely on third parties for their interpretations. An error by a third party or by the lender in reading the maps should not be considered willful neglect of the flood laws.

Another problem is with insuring condominiums. Mortgage servicers are required to have sufficient insurance for each individual units. Unfortunately, calculating the right amount of insurance on an individual unit requires knowledge of the amount of coverage on the building because the building coverage often includes a portion of the unit structure. Condominium associations are not always helpful in giving lenders this information for individual condominium sales and thus in some cases individual units are underinsured.

MBA is also aware of problems with land loans that have so-called "incidental or tear down structures." Once torn down the structure does not need insurance, however, these structures often remain on the property for 6 months or more as the property owner or builder gets the necessary permits. There is understandably much confusion over how to handle these structures since their values are not considered in underwriting the loan and demolition would be a welcomed event. In fact, bank agency rules permit the lender not to require flood insurance on a structure that does not serve as security for the loan. How you carve out the structure from the security has proven problematic and has caused some technical noncompliance. Regulations should make clear that tear down structures do not require flood insurance.

MBA would oppose penalties for these types of interpretational issues, judgment calls, and clerical errors. Lenders have a financial incentive to protect their collateral and to have borrowers purchase flood insurance in SFHA's and they do so.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM J. ROBERT HUNTER

Q.1. What more can be done to ensure communities are complying with NFIP's development requirements in flood hazard areas?

A.1. GAO should be tasked with a baseline study of the degree of compliance in the recent past. GAO sampling actual construction built in participating communities over the last few years can do this. I would start with a statistically significant random sample of building permits issued in several cities and counties with significant building in the floodplain. Make sure to test both coastal and riverine flooding. I would determine if each permit was for a location in the floodplain and, if so, go out and study that actual structure as built to determine if it was built in accordance with the then extant Flood Insurance Rate Map's requirements as to elevations and any other requirements.

These results will test whether taxpayers are getting what they were promised, safer building in the Nation's high hazard floodplains or whether communities and/or developers are routinely ignoring such rules.

Once we see the results of the study, we can determine next steps. It may be that a periodic sampling will be required to assure that some communities that have not done well in the past does better in the future.

Of course, the first step FEMA must do is get rid of the antiquated maps and make sure the maps are kept updated in the future or compliance with the program's requirements will be to no avail.

Q.2. GAO reported, in 2002, that the extent to which lenders were enforcing the National Flood Insurance Program's (NFIP's) mandatory purchase requirement was unknown since the Federal bank regulators believed lenders were generally complying, while FEMA officials believed that many lenders were not complying with the requirements. Since the rate of compliance is an important component in the discussion to further expand mandatory purchase requirements, how do you propose we accurately measure compliance with this existing requirement and improve compliance?

A.2. FEMA can give you the number of policies written by zip code or census tract and perhaps even by where the policies are located within the floodplain, vis-á-vis the 100-year standard. Mortgage lenders should be able to give you numbers of mortgages they write by zip code or census tract. With these data in hand, you should be able to estimate compliance by lender, at least roughly.

In this process, you should make sure you get these data from life insurers and State regulated lenders to see how they are doing to get flood insurance (albeit with no requirement on them) in place for their portfolios. There may be some safety and soundness issues related to these lenders, particularly if they are small with a concentration of mortgages in or around a high flood risk area. Further, such data will make clear if you should require these lenders to obtain flood insurance for their mortgages in floodplains.

RESPONSE TO A WRITTEN QUESTION OF SENATOR REED FROM DAVID PRESSLY

Q.1. What more can be done to ensure communities are complying with NFIP's development requirements in flood hazard areas?

A.1. The NFIP is not simply about providing insurance, but rather is a partnership between the Federal Government and local communities. In exchange for the right to participate in the NFIP, local communities must establish and enforce policies and programs that minimize, mitigate, or offset the risk of building in areas at risk of flooding. As a result, homes constructed since the establishment of the NFIP are safer and sustain less flood damage.

A key step in ensuring that communities are complying with the NFIP's requirements is assuring that the flood hazard areas are adequately and accurately mapped. Up-to-date maps allow communities to accurately determine where to enforce relevant siting and building requirements. Outreach and education are integral components of any program aimed at making use of the best, most up-to-date science. Communities must be made aware of their flood risk, understand what their options are, and be able to appropriately devise local plans, programs, and ordinances to enforce the terms of the NFIP. This is one area where implementation of the

NFIP can be improved, especially given recent nationwide map modernization efforts.

Once the flood hazard areas are determined, and appropriate flood insurance rate maps are adopted, it is up to the local communities, through their particular development approval process and on-site building inspectors, to work with builders to ensure that the appropriate building requirements are being met for new or substantially improved structures. For their part, builders and land developers engage in costly survey and engineering studies to ensure that new or substantially improved structures are built to the proper elevation and meet not only local building requirements, but also internationally standardized construction code requirements and State and Federal environmental protection standards, as well. When communities do not comply with the terms of the NFIP, such as not maintaining or enforcing proper development standards, the NFIP has clear penalties and procedures for revocation of insurance from offending communities (see 44 CFR § 59.24). The threat of loss of availability of insurance is a very strong incentive to encourage compliance with all components of the NFIP, including a given community's particular development requirements. Consistently enforcing the existing provisions for punishing those communities who have chosen not to meet their obligations under the program is both an effective and appropriate manner to ensure that communities are complying with the NFIP's development requirements.