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AN EXAMINATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

HEARING

BEFORE THE

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

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

THE NATIONAL FLOOD INSURANCE PROGRAM

TUESDAY, OCTOBER 2, 2007

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C O N T E N T S

TUESDAY, OCTOBER 2, 2007

WITNESSES

Additional Material Submitted for the Record

AN EXAMINATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

TUESDAY, OCTOBER 2, 2007

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

The Committee met at 10:33 a.m., in room SD–538, Dirksen Senate Office Building, Senator Thomas R. Carper, presiding.

OPENING STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. The hearing will come to order. Good morning.

Today's hearing is on the National Flood Insurance Program. Senators will have 5 minutes for opening statements. I will then recognize Mr. Maurstad and Ms. Williams to offer their testimony to our Committee. Following Mr. Maurstad's and Ms. Williams' testimony, we will have two rounds of questions, then ask our second panel to come forward. Then we will break for dinner.

[Laughter.]

Actually, we are working on the defense appropriations bill, and I am not sure when we are going to have votes, but I am sure we will have some.

The National Flood Insurance Program was established in 1968 as a three-pronged program: insurance, mapping, and smart land use. The NFIP today provides insurance coverage to over 5 million property owners around the country.

Prior to Hurricane Katrina, the NFIP was a self-supporting program. The 2005 hurricane season, though, resulted in FEMA borrowing $20 billion from the Department of the Treasury. In 1989, as Hurricane Hugo was bearing down on the East Coast, I was part of an effort over in the House of Representatives, I think with my colleague—maybe both of my colleagues on either the left or—when did you come to the Senate?

Senator SHELBY. 1986.

Senator CARPER. 1986. Well, you were already here. I think Senator Reed and I were over in the House, and we actually worked on legislation to reform the National Flood Insurance Program.

At the time we were concerned about low participation rates in the Flood Insurance Program, and I had 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 had been responsible for more than a third of all claims, costing about $200 million annually. Our proposal included a call for floodproofing 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 vulnerable locations.

In 1989, a bill to reform the Flood Insurance Program was passed, one not as far-reaching as our earlier proposal, but at least a step in the right direction. It was passed by both the House and the Senate before running into trouble in conference where, unfortunately, it died.

Last year, this Committee passed a comprehensive flood insurance reform bill, and, unfortunately, that bill also died—not in conference but on the Senate floor. Today, 2 years after Hurricane Katrina, we find ourselves again looking at the National Flood Insurance Program. Our main concerns: the low subscription rate, the repetitive-loss properties, the low premiums that do not reflect the vulnerability of the properties being insured.

This time, the tragedy of Katrina will stay with us for a long time because the rebuilding will take, as we know, many, many years, causing us in Congress to continue writing checks for many, many years.

While this is not something that any of us want, perhaps it will help keep the pressure on us long enough to pass a bill, improving the Flood Insurance Program this time—and not just pass a bill, but get a bill to conference, and actually report a bill and send it to the President, a bill that will require us to better consider where we build and rebuild, how we build, and how we allocate risk.

I want to thank Chairman Dodd and our Ranking Member, Senator Shelby, for their leadership on this issue. I also want to thank Jen Fogel-Bublick and Jim Johnson for their hard work as members of our staff on this initiative as well. I do not think Senator Bunning has joined us yet. I know he has spent a fair amount of time on this as well, and my hope is that we can somehow pull together and address this. The authorization for this program I think expires in about a year, maybe at the end of next September, and we have plenty of time to get to work and pass a good, strong bill to send to the President.

There is an old adage that goes something like this: Work expands to fill the amount of time that we allocate to do a particular job. And so we have got about almost 11–12 months to do this job. I do not want us to use all of that. I would like for us to be able to report a bill out of here by the early part of maybe next year, but this hearing today is helpful in sort of setting the stage for some movement on that bill.

Senator Shelby, thank you.

Senator SHELBY. Mr. Chairman, I know Senator Brown has got to go somewhere. I would be glad to swap places with him and yield to him now, and then take it back.

Senator CARPER. That is very gracious.

Senator SHELBY. Go ahead.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you again, Mr. Chairman. Thank you, and also Senator Dodd, Senator Carper, and Senator Shelby. And thanks to the witnesses, especially Chad Berginnis, who is Ohio's State Hazard Mitigation Officer, and I appreciate the work that he does and that so many of you do.

I apologize for having to cut my time here so short because it is a topic that is so important to all of us. I have to go to Arlington today with some World War II veterans. Many of you have been watching the Burns piece on television—more than a piece, the long, long, long series that is so extraordinary.

Many people think of flooding as a coastal problem until it hits your area, as Ohio has experienced a good bit of flooding a year ago, and much, much more, especially in Findlay, Bucyrus, Shelby, sort of northwest/north-central Ohio, in the last couple of months. Nine counties were declared a disaster area by Governor Strickland. Some areas saw the worst flooding in a century. Findlay talked about the last flood they had of any size like this was in 1913, and it sort of begs the question of the whole National Flood Insurance Program. I, with the Governor, spent a day in Findlay back in August talking to people, you know, as they were sort of digging out. It was 2 days after the floods had crested, and they were cleaning their shops, businesspeople, homeowners, all, and few knew much about flood insurance. You know, you would guess that 100 percent of those people had fire insurance. The numbers are something like 10 percent have flood insurance. It is something we need to explain better; we need to sort of perhaps change our attitudes about it and educate people in areas that are prone to flooding better than we have. And it is a program that has worked when it is able to, and we ought to be able to make it work in more situations.

Again, I appreciate what my predecessors have done on this issue and what we are going to be able to build on in the future. And I thank Senator Shelby for yielding.

Senator CARPER. All right. Senator Richard C. Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

The National Flood Insurance Program, as you mentioned, is currently $20 billion in debt and lacks the resources to service that obligation. Unfortunately, the program's debt is only one of the many difficulties facing the future of the taxpayer-backed flood insurance.

In recent years, there has been a population explosion, as you well know, in coastal areas all over this country. Millions of Americans now live and work in structures worth billions of dollars that are located in some of our Nation's riskiest areas. It is likely that this phenomenon will continue and the demand for Government-provided flood insurance will grow.

In light of this growing migration to our coastal areas, our examination of the flood program needs to be prospective as well as retrospective. We already know that the program has failed to meet the demands of the past. We must now determine whether the program is properly designed to handle trillions rather than billions of dollars' worth of property loss.

During the 109th Congress, this Committee held multiple hearings on the National Flood Insurance Program. After thorough examination, we unanimously—Democrats and Republicans unanimously—approved legislation intended to address many of the problems with the program. The bill eliminated subsidies on vacation homes, businesses, and severe repetitive-loss properties. It also established a process for the elimination of all subsidies in the future. The bill also addressed the insufficiencies in the existing maps by establishing stringent standards that the program must use to complete the modernization process, which is a must.

The bill required State-chartered lending institutions to maintain flood insurance coverage for all mortgages located within the 100-year floodplain. The bill also enhanced the enforcement tools available to bank regulators at the Federal and State levels by requiring escrow of flood insurance premiums throughout the life of the mortgage and by increasing the civil penalties regulators may levy for failure to comply. Finally, the legislation created a mandatory reserve fund to pay future claims without additional contributions from the taxpayer. Unfortunately, as has been pointed out, the 109th Congress failed to take up this legislation before it adjourned.

In the interim, a number of studies looking at difficult facets of the program have been initiated. Two have been completed. Recently, the GAO completed the first part of a two-part examination of the public-private partnership between insurance companies and the Flood Insurance Program known as "Write Your Own." The GAO is still looking at what this program costs private insurers to administer on behalf of the Government because FEMA, surprisingly, was unable to do so.

When this partnership was created, the program was supposed to reimburse expenses for the Write Your Own carriers. Profit was not supposed to be part of the agreement. Initial indications are that many companies are not only profiting from this arrangement; property and casualty companies have been created solely for the purpose of administering this program. In other words, it is their only business.

Another study produced by the Congressional Budget Office, or CBO, examined the value of pre-FIRM subsidized properties within the program. The Congressional Budget Office determined that 40 percent—yes, 40 percent—of subsidized coastal properties in their study sample are worth more than $500,000 and 12 percent are worth more than $1 million, at a time when this program is $20 billion in debt. These findings provided further validation of this Committee's previous approach on taxpayer-funded subsidies.

The National Flood Insurance Program is now at a crossroads. The 2005 hurricane season was most certainly a jarring wake-up call, but we cannot be guided only by the lessons of a single hurricane season as we move forward. We know demographic trends have placed and are likely to place more strains on the fiscal resources of the program. As those demands become more considerable, I think it is incumbent upon us to better understand the costs and the risks attached to this program.

Last Congress, as I said, this Committee unanimously agreed on a way forward. I believe we can do so again.

Thank you, Mr. Chairman.

Senator CARPER. Thank you, Senator Shelby.

Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you very much, Mr. Chairman, and thank you and Senator Shelby for holding this hearing. I want to welcome the witnesses. I particularly want to welcome Dr. Galloway, who I appreciate not only for his service as an engineer but as a general officer in the United States Army, 38 years' service, including service as Dean of the Academic Board at West Point. Thank you, Doctor General, for your work.

Today, more than half the United States population lives in coastal counties, and that number will continue to grow in the future. Development is changing coastal ecosystems, and global warming will produce more intense storms and sea level increases. These events will place communities at greater risk, and reforms to the Flood Insurance Program are absolutely 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.

Amid several concerns regarding the current National Flood Insurance Program, I will focus my comments very briefly on the issue of FEMA's flood insurance rate maps, known as FIRMs. Floods are the most common and destructive natural disasters in the United States. Accurate flood maps should be the foundation of the NFIP. Flood insurance can mean the difference between a family having $250,000 to rebuild after a flood or literally being wiped out.

As such, I have focused my attention in this legislation on the National Flood Insurance Program mapping program. I introduced the National Flood Mapping Act of 2005 during the last Congress, and I am pleased to see it included by the Committee in the NFIP legislation. I will continue to urge that this legislation be adopted.

There is one particular issue I want to address now and I look forward to the witnesses' comments on, and that is, my bill will require mapping of the 100-year floodplain plan along with the 500-year floodplain plan and areas of residual risk. Some have suggested that mapping the 500-year floodplain as part of FEMA's Map Modernization Program could lead to delays in updating the 100-year floodplain plan. I do not believe that. FEMA already includes a 500-year floodplain on its maps. Collecting this data and adding this information is absolutely the right approach and imperative to the public's right to know about their flood risk, and we should not fragment these efforts.

I am, again, very pleased that the Committee is taking up this issue, and I look forward to the testimony of the witnesses.

Thank you very much, Mr. Chairman.

Senator CARPER. Thank you, Senator Reed.

And next let us turn to Senator Dole. You are next.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Mr. Chairman and Ranking Member Shelby. I appreciate your holding this hearing on the National Flood Insurance Program, which covers approximately 132,000 homes in North Carolina. Many people who live in these homes have felt the impact of flooding in the wake of hurricanes like Isabel, Frances, Floyd, and Ivan.

Researchers from NOAA forecasted a very active 2007 hurricane season. They forecasted 13 to 15 named Atlantic tropical storms, with as many as 9 expected to reach hurricane strength and 3 to 5 growing into very dangerous hurricanes with winds of at least 111 miles per hour. NOAA states, and I quote, that "Historically similar conditions have typically produced two to four hurricane strikes in the continental United States and two to three hurricanes in the region around the Caribbean Sea."

Of course, it is not possible to estimate the number of landfalling hurricanes. The bottom line is that we must be prepared. Government at every level must stand ready to provide assistance.

We have been very fortunate that major hurricanes have not hit the United States during the past 2 years, but we cannot and should not wait for another major catastrophe before we reform the National Flood Insurance Program.

Over the past 10 years, there have been many costly hurricanes that have weighed heavily on this program. In North Carolina, the program has been critical to our recovery from a number of major storms. In the fall of 1999, the eastern part of North Carolina was hit by Hurricanes Floyd and Irene. Floyd wreaked havoc, flooding many small communities. In Princeville, for example, the flooding completely swept away the town, leaving people to relocate or live in temporary housing until their homes could be rebuilt. To this day, in Greenville, North Carolina, you can still see the water lines on the buildings which mark the flood's highest point. The National Flood Insurance Program paid out over $460 million for Hurricane Floyd, with approximately $200 million of it going to North Carolina.

In recent years, our State has also experienced devastating flooding in the mountains. With rains from Hurricane Ivan, mountain valleys began to fill, with normally small creeks and streams turning into raging rivers. In total, the Flood Insurance Program paid out more than $1.5 billion in claims for this storm, of which $10 million went to relief efforts in North Carolina.

Though these and other storms have been quite costly for the Flood Insurance Program, no one could have foreseen the strains caused by Hurricanes Katrina and Rita. To date, FEMA has handled 241,000 claims and has paid out approximately $16.3 billion stemming from the 2005 hurricane season. In March 2006, Congress raised the program's borrowing authority to almost $21 billion. FEMA still anticipates paying approximately $21.9 billion in claims, more than the program has paid out in total over its 30-year-plus history.

In North Carolina, we recognize our vulnerability to flooding, and our State is proactively undertaking one of the most advanced mapping programs in the Nation to better identify areas of risk. With FEMA's support, our maps can provide local, State, and national officials with a clear picture of areas vulnerable to floods. In turn, communities can properly plan current and future development. While I had some concerns about last year's Flood Insurance Reform and Modernization Act, I fear that inaction could result in a far worse situation.

Again, I want to thank you, Mr. Chairman, Senator Shelby, for devoting time to this very important program, and I look forward to hearing from our witnesses.

Senator CARPER. Thank you, Senator Dole.

Next if we could hear from Senator Casey, please, and he will be followed by Senator Allard.

STATEMENT OF SENATOR ROBERT P. CASEY

Senator CASEY. Mr. Chairman, thank you very much, and Ranking Member Shelby and our guests, the panelists who will be here today.

I wanted to first of all give you a sense of the State I am from—Pennsylvania—where we have had more than our share of flooding, not just in the last couple of months and couple of years, but really for many, many generations, as far back as probably the most infamous and destructive inland flooding, which was in Johnstown, Pennsylvania, on Memorial Day of 1889. That community suffered several others many decades later, but there are other seemingly less dramatic examples of that. So we have suffered tremendous loss over many years.

And I guess what we are trying to do with this legislation, any reform initiative, is to first of all be fair, to make sure, of course, that this program is actuarially or fiscally sound, and also to ensure that we are, as best we can, building in incentives for both existing homeowners and those who are seeking to develop in new areas of a particular community. And I think, of course, the mapping priority that is so prominent in this discussion is something we are very concerned about, getting the mapping right so we have accurate data.

In our States, flood insurance policyholders receive the second highest total of claims—claims payments, I should say, in the United States after the 2004 hurricane season, and heavy summer rains and inland-moving tropical systems threaten homeowners throughout the State during the summer season virtually every year. In the past 10 years, Pennsylvania has experienced more than 15 flood-related federally declared disasters. In the period 2002 to 2006, insured flood losses totaled more than $337 million. That gives you a sense of the dimension.

But I visited a community in Allegheny County in the southwestern corner of our State, just outside of Pittsburgh, this summer—a community by the name of Millvale—that did not suffer enough losses to rise to the level of being awarded Federal help. But even in that instance, where, when you compare it to other examples, it may not seem as dramatic or as devastating, for that community there is a sense of hopelessness, a sense of helplessness, that sometimes Government itself cannot even respond to appropriately. And that is not necessarily the fault of the Federal Government all the time. It is not necessarily the fault of our laws. But we have got to make sure that as we reform this legislation and as we inform ourselves about the best way to do that, we remember the human trauma that these incidents cause in the lives of so many families. And I just want to make sure that we are cognizant of that as we are listening to the testimony.

We appreciate the expertise that is brought to bear on this hearing from our panelists, and I appreciate the opportunity to spend some time here this morning in this hearing. Thank you.

Senator CARPER. Senator Casey, thank you very much.

Senator Allard, you are recognized.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman. I would like to also thank you for holding this hearing, as well as Ranking Member Shelby.

Contrary to what many might think, flood insurance is an important program for my constituents in Colorado, too. It is not just for citizens of coastal areas. Our topography often acts as a funnel for rain or runoff, resulting in flooding even with smaller amounts of water. In such instances, the National Flood Insurance Program can be an important Government tool to help prevent or minimize flood damage and facilitate recovery efforts when damage does occur.

In 2004, this Committee produced a series of important reforms designed to make the National Flood Insurance Program more effective. I was pleased to support the legislation. Following the 2005 hurricane season, though, it became clearer that the National Flood Insurance Program was in need of much more fundamental reform.

I believe that the bill reported by this Committee last year was a good step in addressing that need, and I was disappointed that we were unable to enact the reforms. Without them, we are left with a program that is both broke and broken.

I am hopeful that we can move in an expeditious manner this fall. Not only do we have a legal obligation to pay the claims of those who purchased flood insurance policies, but we also have an ethical obligation to the people who are responsible enough to buy appropriate insurance. We must ensure that flood insurance continues to be available for those who need it, as well as we must do 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 also remain deeply concerned with the state of the floodplain maps. 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 satellite and high-altitude mapping capabilities to improve the current mapping system.

Millions of people have taken steps to protect their home and family by purchasing a flood insurance policy. But 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. I thank the witnesses for appearing here today to share their views.

Thank you, Mr. Chairman.

Senator CARPER. Thank you, sir.

Senator Schumer, just in time.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. I will not sing that famous song, because it will ruin it.

Anyway, I want to thank you, Chairman Carper, for chairing this hearing today. I want to thank Chairman Dodd and Ranking Member Shelby as well.

Recent events have shown our current system of insurance for coastal flooding needs serious examination. The program has had some recent problems, we all know, but it still can be considered a qualified success. And that being said, there are certain areas where the Flood Insurance Program can and should be improved. One of these areas is how FEMA determines high flood risk areas, known as 100-year floodplains because their risk of flooding is more frequent than once every 100 years.

Under the National Flood Insurance Program, every mortgage made by a federally backed or insured lender in a 100-year floodplain must have flood insurance, and this policymakes a great deal of sense for those areas with high risk of flooding.

But while the policy makes sense, the execution is sorely lacking. We have had a particular problem up in the Buffalo area. FEMA has continually classified certain areas of Buffalo 100-year floodplains, despite the fact that there has never been a single flood claim in these areas in the history of the National Flood Insurance Program, despite the fact that Buffalo has recently invested heavily in flood mitigation infrastructure. It results in unnecessary insurance costs for residents of those areas.

On August 24th, I sent a letter to FEMA asking them to send a representative to personally examine the flood prevention measures adopted by Buffalo and determine if the 100-year plain designation was still appropriate. And I would say this to you, Mr. Maurstad—I know we do not have questions yet, but despite my request, FEMA has yet to send anyone to Buffalo. And I hope that you will. You need to recognize the potential flaws in the flood mapping methodology and refrain from issuing any new flood map until it has first sent a representative to Buffalo to see firsthand the city's flood prevention improvements.

It is sort of ironic here. In certain places, we are saying FEMA does not do enough and flood insurance does not do enough, and yet they are requiring flood insurance in all kinds of areas that do not need it. So we ought to sort of get our house in order.

Another aspect of the National Flood Insurance Program that merits close examination is whether it truly provides enough coverage against real flooding. In New York, in the aftermath of Katrina, many insurance companies stopped writing new homeowner insurance policies and canceled existing policies, particularly for the coastal areas of Long Island. This occurred in spite of the fact that downstate New York has not experienced a major hurricane since Hurricane Gloria in 1985, and that was a Category 1 storm—not a 5 or a 3 but a 1.

Insurance companies, which have historically profited immensely from insuring downstate New York, now appear to be reconsidering whether they should continue to insure areas that are even at slight risk of hurricanes. I point this out not to blame the insurance companies—although, in my opinion, the insurance companies that have fled Long Island do deserve a great deal of blame—but to highlight the fact that there may be larger issues with the National Flood Insurance Program that need to be addressed.

The insurance industry wants to cash out its chips on Long Island, but homeowners cannot afford this kind of gamble. Why are insurance companies leaving Long Island because of hurricane risks even though flood damages are already insured by the Federal Government? One answer may be that the maximum amounts covered by the National Flood Insurance Program are simply too low for areas with higher construction and rebuilding costs, and clearly, Long Island, where the average house—average small house—sells for $450,000.

Currently, the maximum amount on a home structure by the NFIP is $250,000, and that is not high enough. That is one reason the House bill raised the amount to $335,000, and, in fact, the number may be not—that number is not good enough, as I mentioned, for large parts of Long Island.

So the point is we have a flat national amount. You know, maybe in Mississippi where construction costs and housing costs are much lower it makes sense, but it does not make sense in New York. And it is unfair to say to a person in New York who has an average house, you do not get flood insurance, but to say to a person in another State, even if you are at 80 percent of the percentile in terms of cost of your house you do. So maybe we should look at higher-cost areas to do it.

Now, another reason insurance companies may be leaving Long Island is that even though the Flood Insurance Program is covered by the Federal Government, private insurers are increasingly unwilling to cover the risk of wind damage. As we all know, hurricanes cause both flood- and wind-related damage. Since the creation of the Flood Insurance Program, the Federal Government has covered flooding; private insurance has covered wind. Perhaps the private insurance industry has lost its appetite to insure against wind damage. If that is the case, should the Federal Government step in to insure those homeowners who would otherwise be without insurance, provided this insurance is done in an actuarially safe and sound manner? The House of Representatives seemed to think so. They put it in their bill. I believe we should do the same in the Senate and will work toward that.

The private insurance industry says, no, no, no, let us cover wind, and then they leave areas like Long Island. Gentlemen, ladies, you cannot have it both ways. You want to exempt yourself from large parts of America, and certainly of New York? Then do not lobby against the Federal Government coming in and doing it.

So I look forward to hearing from representatives of the insurance industry. I would like to hear their perspectives on why the insurance industry has pulled out of Long Island and what they think can be done for residents in those areas. I appreciate the time, Mr. Chairman and having this timely hearing.

Senator CARPER. Thank you very much.

Our next Senator who is going to be recognized is Senator Bunning, who has done a lot of work, and we thank you very much not only just for doing it, but for your leadership for the last several years on this.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman. Thank you, Senator Shelby, also. I am glad we are finally holding a hearing on the National Flood Insurance Program, which expires next year. I hope we can soon pass a reform bill that builds on the significant reforms enacted in the 2004 reauthorization written by my Subcommittee.

Last year, this Committee passed a good reform bill that would have made the program more financially sound and provided better protection to the taxpayers. Even though it did not go as far as I would like, the bill would make a good starting point for the new reauthorization.

As we saw in 2005, the current program is a financial disaster waiting to happen. The storms of 2005 exposed all the flaws in the program and have cost the taxpayers more than $20 billion. Without any reforms, the same thing will happen again.

The current program is not financially sound and encourages property owners to take risks that put them in harm's way. Even worse, many of the subsidized policyholders do not even need the help since they are already wealthy or taking insurance on their vacation homes. The taxpayers should not have to bear that burden.

I have made no secret about my lack of faith in the management of this program. It took over 2 years from when the 2004 reforms were signed into law for FEMA to create the appeals process required by the law. So I am not surprised by the recent GAO report that found that FEMA in some cases has been paying the insurance companies and agents that sell flood insurance policies almost two-thirds of the premium in administrative cost. Those numbers are unacceptable, and we need to address that as well.

I am looking forward to hearing from our witnesses. Thank you again, Mr. Chairman.

Senator CARPER. You bet. Thank you, Mr. Bunning.

I think, Senator Martinez, you are the last man standing. You have got a lot at stake given the nature of the State that you represent and given the job that you held before as HUD Secretary. I know you have thought a lot about this, and we look forward to your comments.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Thank you, Mr. Chairman, Senator Shelby. I appreciate it very much. It is a program that has been helping American families since 1968, but we know the problems that were exposed in the program, particularly after Hurricanes Katrina, Rita, and Wilma, which did show some serious flaws in the program.

The 2005 Gulf Coast hurricanes were catastrophic disasters that required over $110 billion in Federal disaster relief, including almost $22 billion in claims payouts under the National Flood Insurance Program. The program has had to borrow money extensively from the Treasury in order to pay claims and expenses, and Congress has had every right to be concerned about the programmatic and financial challenges facing the National Flood Insurance Program.

Last year, this Committee worked very hard to pass a flood insurance reform bill, as Senator Bunning just alluded to, and this bill would have made a number of positive changes in the program. Among those provisions, the legislation would have provided debt forgiveness, required mandatory coverage areas, and strengthened FEMA's mapping program.

Although I remain concerned about eliminating subsidized premium rates for certain properties and raising the deductible level of claims, I nonetheless do support the overall effort to improve and strengthen the program so that it can continue to provide insurance coverage to millions of Americans in harm's way.

I appreciate the witnesses' being here today and look forward to their testimony, and as you know, the House recently passed a flood insurance reform package that substantially differs from this Committee's legislation from last year. I am particularly interested in hearing from our witnesses about the importance of debt forgiveness as well as the ramifications of adding wind coverage to the program.

The strengthened viability of the National Flood Insurance Program is incredibly important to my home State of Florida. There are over 2 million NFIP policies on homes in Florida, representing over 40 percent of the entire program. We cannot wait any longer to make serious reforms to this program. We have a responsibility to ensure that those who rely on flood insurance to live and work in their community will have the security they desperately need and rely on.

Mr. Chairman, I thank you for calling this timely hearing, and I look forward to the testimony from our witnesses and continuing this very important conversation about the future of this program. Thank you very much.

Senator CARPER. Thank you, Secretary Martinez.

Now, to our first panel, you have had the opportunity to hear from us. Now we will have the opportunity to hear from you, and we look forward to that. It is interesting. I have just a couple of observations. One, we had a pretty good turnout here today, and I was wondering how many—I thought it might just be Senator Shelby and me up here, maybe with Senator Bunning, but we have a pretty good turnout in terms of our Senators, and I think that bodes well. The only other hearing I ever chaired at the full Committee level was FHA, and it lasted about 10 minutes. It was one of those deals where somebody objected over on the Senate floor—not to my chairing, but to any committees meeting. So we had to leave after about 10 minutes. Richard here made me leave. I was tempted to keep us here, but he said, "No. You have got to go. You will go to jail if you keep it in session."

[Laughter.]

Senator SHELBY. I do not know if you would go to jail, but I just thought that was the Senate rules.

Senator CARPER. Playing by the rules.

Anyway, among the words we hear most on the Senate floor and in committees is the word "reform." If you think about it, we hear that. We also hear "bipartisan." It is not always bipartisan, and a place that we talk a lot about reforms; sometimes we do not fully deliver. But we need to deliver on this one, and I am pleased to see the kind of turnout we have had here today, and the interest. And this is maybe an issue whose time has come once again.

So, Mr. Maurstad, David Maurstad, I understand you are the Assistant Administrator for Mitigation and the Federal Insurance Administrator for FEMA, and we welcome you. I will probably recognize you first, unless you want to defer to Ms. Williams. Why don't you go first, Mr. Maurstad?

And then Orice Williams, Director of Financial Markets and Community Development for GAO. We are delighted that you are here, and we welcome you both.

Mr. Maurstad, why don't you lead us off, and then we will recognize Ms. Williams. And I would ask you to keep your comments to about 5 minutes, and we will enter your full statement into the record.

STATEMENT OF DAVID I. MAURSTAD, ASSISTANT ADMINISTRATOR FOR MITIGATION AND FEDERAL INSURANCE ADMINISTRATOR, FEDERAL EMERGENCY MANAGEMENT AGENCY, DEPARTMENT OF HOMELAND SECURITY

Mr. MAURSTAD. Thank you. Good morning, Senator Carper, Ranking Member Shelby, and Members of the Committee. I appreciate the opportunity to appear this morning to address the NFIP's financial status, how the 2004 Flood Insurance Reform Act has made the NFIP more effective, and opportunities to improve this program, and I am prepared to answer any questions on map modernization that you might have after the testimony.

The NFIP makes affordable flood insurance available in communities that would adopt and enforce measures to reduce vulnerability to flooding. From 1968 through 2004, the NFIP paid out $15 billion to cover over 1.3 million claims. Hurricane Katrina alone resulted in claims totaling over $16.3 billion, and we expect the 2005 flood insurance costs to approach $20 billion, including interest paid on borrowing from the Treasury—borrowing that enabled the NFIP, in partnership with our insurance company partners, to pay over 98 percent of the 2005 flood claims. That is more than 180,000 Gulf Coast residents helped on the road to recovery by the claim payments from their NFIP insurance policies.

To date, the NFIP has borrowed $17.535 billion to pay for Katrina, Rita, and Wilma claims and the required interest—interest that likely will exceed $800 million a year by 2009, when we expect to approach our congressionally approved $20.775 billion borrowing limit.

If future claims meet historical averages, the NFIP will need new loans every 6 months to cover semiannual interest payments, making it unlikely that the NFIP will ever be able to retire its debt.

Financial matters aside, the program has performed well, particularly since the finalization of the 2004 Flood Insurance Reform Act. The NFIP Summary of Coverage and the Flood Insurance

Claims Handbook have been important additions to the program, playing a major role in helping policyholders better understand their coverage and helping the NFIP close claims quickly and fairly. Supplemental and acknowledgment forms now accompany every new and renewed flood insurance policy, providing policyholders with easy-to-understand coverage explanations.

In addition to better informing policyholders, the NFIP has greatly increased the number of agents who are trained to sell flood insurance. Since September of 2005, 42 States and the District of Columbia have made flood insurance training mandatory for agents selling NFIP coverage, and over 42,000 agents have completed our basic agent tutorial, either online or in the classroom.

Of course, education and training can only reduce, not eliminate, claim settlement disputes. That is why FEMA adopted the Flood Insurance Claims Appeals Rule, offering policyholders a clear avenue to appeal decisions of adjusters, agents, companies, and FEMA. This rule enhances the program's historically high success rate of resolving over 99 percent of its claims without litigation.

Finally, the reform act helps FEMA address repetitive-loss properties. The Repetitive Flood Claims Program distributed a total of $19.8 million in fiscal years 2006 and 2007 to help communities remove more than 80 buildings from floodplains. We have also transferred $80 million from the National Flood Insurance Fund, ready to help States and communities mitigate severe repetitive-loss properties. And in fiscal year 2007, our Flood Mitigation Assistance Program committed $31 million to States for various floodplain management projects and plans.

These programs, combined with flood insurance and other mitigation activities, are important elements of a systematic effort to eliminate the flood-rebuild-flood scenario that the Nation's flood-prone communities have become all too familiar with. And we must keep improving, which means strengthening the NFIP programmatically and operationally to protect the program's financial integrity, increase NFIP participation, improve citizens' understanding of flood risk, and reduce risk with proven mitigation practices. We should enhance these principles by eliminating discounts on pre-FIRM structures, increasing penalties for federally regulated lenders who do not comply with their mandatory purchase regulatory responsibilities, and providing more ICC coverage for policyholders to bring their structures up to flood-related building codes.

Also, as recommended by a recent GAO report, the NFIP must have reasonable estimates of Write Your Own expenses and ensure their financial audits are performed on time, without exception. Finally, we are opposed to increasing the NFIP's scope of coverage. A costly multi-peril NFIP will not resolve the wind versus flood issue or reduce vulnerabilities in wind-prone communities. My written testimony offers additional details and suggestions.

Finally, we are concerned about more than financial matters. The NFIP is a leader in educating the Nation's homeowners about flood risk, but we cannot do it alone. Local government leaders must also inform citizens about their risks and make the difficult land-use planning and management decisions needed to build communities that are a safer place to live, work, and do business.

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

Senator CARPER. Good. Thank you, Mr. Maurstad.

Ms. Williams, in recognizing you, let me just say from all of us our special thanks to GAO for the work that you have done in this area and for the product that you brought to us. Thanks. You are recognized.

STATEMENT OF ORICE WILLIAMS, DIRECTOR OF FINANCIAL MARKETS AND COMMUNITY INVESTMENTS, GOVERNMENT ACCOUNTABILITY OFFICE

Ms. WILLIAMS. Thank you. Senator Carper, Ranking Member Shelby, and Members of the Committee, I am pleased to be here today to discuss the challenges facing the National Flood Insurance Program. My comments are based on numerous reports and testimonies GAO has provided over the years as well as several ongoing engagements. I would like to briefly touch on four major challenges facing the NFIP and FEMA, which oversees the program.

First, as you well know, one of the biggest challenges facing the NFIP is the actuarial soundness of the program. As of August 2007, FEMA owed over $17.5 billion to the U.S. Treasury, largely resulting from losses during the 2005 hurricanes. This is significant because FEMA is unlikely to be able to repay this debt, primarily because many of the program's premium rates are set to cover losses in an average historical loss year, which, until 2005, did not include any catastrophic losses.

Moreover, to balance the need to keep the costs of flood insurance affordable, Congress included premium subsidies for certain properties; that is, about one in four NFIP policies have premiums that represent 35 to 40 percent of the true risk premium. Also contributing to the NFIP's financial challenges are the more than 70,000 properties that suffer repetitive losses. While these properties represent about 1 percent of all NFIP-insured properties, they account for between 25 to 30 percent of all NFIP flood claims.

FEMA is also creating a new category of policyholders that pay premiums that may not reflect their current risk of flooding. Specifically, eligible properties that are remapped into higher-risk flood areas are able to pay a discounted rate that reflects their old risk level.

Second, the NFIP also faces challenges expanding its policyholder base by ensuring compliance with mandatory purchase requirements and promoting voluntary purchase by property owners who live in areas that are at less risk.

A recently commissioned FEMA study estimated that 75 to 80 percent of homeowners most likely to be required to have flood insurance have it. At the same time, only half of those living in high-risk areas are estimated to have flood insurance. Moreover, the penetration rate nationwide was only 1 percent, yet every State in the Nation is susceptible to flooding.

Since 2004, FEMA has implemented a mass media challenge called "FloodSmart" in an attempt to educate the public about the risks of flooding and to encourage the purchase of flood insurance. While numbers of policyholders have increased following Hurricane Katrina, it is unclear whether these policyholders will remain in the program as time goes on and memories of the 2005 hurricanes fade.

The third challenge is map modernization. The impact of the 2005 hurricanes highlighted the importance of having accurate, up-to-date flood maps that identify areas that are at greatest risk. While requirements for purchasing flood insurance apply only to certain properties in high-risk areas, according to FEMA, about half of all flood damage occurs outside high-risk areas. While FEMA has begun to take steps to adjust its map modernization efforts by changing its mapping standards and guidelines and adopting risk-based mapping priorities, managing this process and producing accurate digital flood maps is and will be an ongoing challenge.

Finally, I would like to briefly touch on the challenges FEMA faces in overseeing the NFIP. This includes the need for effective oversight over the industry companies and thousands of insurance agents and claims adjusters that are primarily responsible for the day-to-day process of selling and servicing insurance policies.

In closing, as we have said before, meeting the NFIP's current challenges will require sound data and analysis and the cooperation and participation of many stakeholders. We appreciate the difficulty of restoring the financial viability of this program while balancing complex public policy objectives that may be at odds.

Senator Carper, Ranking Member Shelby, this concludes my oral statement, and I would be happy to answer any questions that you may have.

Senator CARPER. All right. Thank you. Thank you both. When you combine the time that each of you used up, it was exactly 10 minutes. That was perfect.

Let me start with Mr. Maurstad, and I am going to just try to recognize our members for 5 minutes, and we will go to a second round for those who have additional questions.

Mr. Maurstad, you mentioned and Ms. Williams has mentioned and I think probably most of my colleagues have mentioned in their comments the issue of flood mapping. One aspect of flood insurance that is sometimes overlooked, though not in our testimony today, is flood mapping. Many of the witnesses here today that are going to follow the two of you today discuss flood mapping in their testimonies, and some at great length.

Now, I want to better understand where FEMA is in terms of updating and maintaining maps. As I understand it, there are flood maps that are two decades old, in some cases, in many cases, clearly not providing meaningful risk assessments or information. And my first question would be: When does FEMA expect to be done with updating all flood maps? And do you have the resources that you need to update all maps?

Mr. MAURSTAD. Well, Senator, you are absolutely right about your comments on the state of the flood maps prior to the map modernization process. We are now into that a number of years. We are looking at in the current phase of map modernization, the funding will end in 2008. The map production will conclude sometime during 2010, because it generally takes a couple of years for the mapping process—the development of the maps and then the appeal and adoption process at the local level.

Senator CARPER. Let me just interrupt. Does the mapping process work today differently than it used or do you have better technology and you are able to do a much better job?

Mr. MAURSTAD. The process is the same. The length of time—depending upon the type of study that is done will dictate how long that takes, how much data is available at the local level that can be shared with the program. But then when we turn those maps over, then it is up the community, and that can vary anywhere from 6 months to 2 years in the appeal and the adoption process at the local level. So that process is not really changed.

Senator CARPER. Our technology allows us to do a lot of things today far more quickly than they could in 1968. Mapping is not one of them?

Mr. MAURSTAD. Development of the maps, certainly technology allows for better development of the maps. I am saying the total process, the public hearing process, the sharing with the community process, that takes the same amount of time.

Senator CARPER. Excuse me. Does technology allow us to develop maps at a more reasonable cost than was previously the case?

Mr. MAURSTAD. I believe that there is cost savings associated with the current technology compared with the old paper maps. We are certainly able to do more, and those maps, more importantly, I think, in the future will be able to be maintained and updated at less cost than what the paper maps were able to do. So there certainly will be benefits associated with that.

To get to the heart of your question, at the end of the process, this current phase, we expect to have 92 percent of the Nation's population with new digital maps covering about 65 percent of the land area.

Senator CARPER. Just a related question in addition to updating maps. Maintenance is clearly needed. You have talked a little bit about that. But what are FEMA's plans to maintain maps? And what are your assessments for how much you will need annually to maintain flood maps on an ongoing basis?

Mr. MAURSTAD. Well, we certainly have learned during this process, working with our State and local stakeholders, that there is a continued need for new engineering studies. The current phase, even though we made an adjustment to focus on risk in 2006, a mid-course adjustment, we have found that there are many communities around the country that need additional engineering studies to provide the best flood mapping information to them.

Now, every community of the 20,000 probably would want to have that engineering study. I doubt that we will ever be able to afford to do that. But we will certainly be able to and need to continue to work toward developing the resources to be able to have engineering studies on all of the high-risk areas throughout the country.

Senator CARPER. Again, did you say—you may have said it and I missed it, but your best estimates for how much you will need annually to maintain flood maps on an ongoing basis?

Mr. MAURSTAD. Well, we are working right now on our current budget proposals. Again, I think that certainly we are going to be looking at the funding beyond this phase, depending upon what is appropriated by Congress. About $56 million will be available from the ratepayers to continue the maintenance and some limited additional new maps. Beyond that, I think that it is fair to say that there are estimates—I think some of the folks that will testify after me have developed estimates on what they believe will be needed into the future. We are still working on developing that number.

Senator CARPER. All right. Thank you.

Senator Shelby.

Senator SHELBY. Ms. Williams, GAO has reported that accurate, updated flood insurance maps are the foundation of the National Flood Insurance Program. Is that correct?

Ms. WILLIAMS. Yes.

Senator SHELBY. Are you satisfied, from the standpoint representing the General Accounting Office, with FEMA's efforts to improve and update the flood maps? And if not, why not?

Ms. WILLIAMS. I think our position, as I mentioned, map modernization is and is going to be an ongoing challenge. We did recognize—after our 2004 report, we laid out a number of recommendations about improving guidelines given that FEMA has to deal with communities with varying levels of resources and skills and abilities that they needed consistent guidelines to make sure the process was occurring consistently across the country. And we did recognize that FEMA did come up with guidelines. They made a mid-process adjustment, and they did improve some of those guidelines.

In terms of where they are in the process, the latest information we obtained from FEMA was that 34 percent of the maps have been remapped, and this 34 percent includes effective maps as well as preliminary maps. So I think the 34——

Senator SHELBY. Are those 34 percent mainly located in the Gulf Coast area, or are they everywhere?

Ms. WILLIAMS. Well, it varies. There's a definite concentration in North Carolina, for example, and then there have been remapping efforts—they do tend to focus on the coast, and then fewer on the West Coast, for example, so it is scattered along the East Coast.

Senator SHELBY. Is part of the problem in moving forward the bureaucracy, the local input and so forth? Does that slow it down?

Ms. WILLIAMS. It is part of the challenge, and part of that has to do with the outreach effort that goes on as a community either, one, makes the decision that they want to be remapped and they have worked——

Senator SHELBY. Wait a minute. Excuse me.

Ms. WILLIAMS. Yes.

Senator SHELBY. The local community will decide whether they want to be remapped?

Ms. WILLIAMS. Well, it is my understanding in terms of priority that part of FEMA's process was that the communities that had taken the step to create, for example, the base map—the communities are often responsible for coming up with the base map that FEMA will work with to put elevation over.

Senator SHELBY. Doesn't the Corps of Engineers and FEMA have a data base for all this, you know, for the 100-year floodplain that we talk about in most areas? Do they not?

Mr. MAURSTAD. A couple of comments, if I could, Senator. First of all, there is new mapping going on in every State——

Senator SHELBY. We hope so.

Mr. MAURSTAD [continuing]. All across the country. It is not just in the coastal areas. The focus has been within those States for them to identify the high-risk areas in the States.

Yes, there is a base level of information that is used. That is what is being, in essence, converted from a paper environment to the digital environment. That is a starting point for the new digital maps.

Senator SHELBY. Ms. Williams, the General Accounting Office, it is my understanding, has determined that the National Flood Insurance Program has absolutely no basis for determining the cost for insurers to administer this program—in other words, the program. Can you explain this finding to the Committee?

Ms. WILLIAMS. Yes. On that particular issue, in September we issued a report that looked at the payments made to the Write Your Own companies, and what we found when we looked at the payments made, there really was not an ability for us to also look at the expenses that were incurred by the Write Your Own companies. And so not only could we not determine whether or not that amount was an appropriate amount, I think what was more alarming is that FEMA was unable to tell us that this was an appropriate amount based on a review that they had done.

Senator SHELBY. OK. Director Maurstad, are you concerned about conflicts that people have pointed out when a single insurance adjuster performs a claim analysis for both the wind- and flood-related damages? And what steps does the National Flood Insurance Program take to address such conflicts?

Mr. MAURSTAD. First of all, I think there are always going to be conflicts in the adjustment process, and it is not solely——

Senator SHELBY. This is a big one.

Mr. MAURSTAD. Yes. Not solely between——

Senator SHELBY. Is it water only and——

Mr. MAURSTAD. The single adjuster. The single adjuster program is actually an outgrowth of a request at the State level for one adjuster program to coordinate payments made under the State wind pools along with the Federal flood program. The Write Your Own companies can also utilize that, according to the arrangement that we have with them. I believe we have got appropriate mechanisms in place to be able to make sure that the flood claim is paid fairly and accurately according to the provisions of the flood insurance policy.

Senator SHELBY. Ms. Williams, the GAO, in your statement you say you are currently looking into the conflicts of interest that can arise when an insurance company sells both property casualty and flood policies to a single homeowner. When will your analysis in that area be complete? And will you furnish that to the Committee?

Ms. WILLIAMS. Absolutely. I would be glad to provide a copy, and the report should be issued in the next 2 months.

Senator SHELBY. Is that a concern for you at GAO?

Ms. WILLIAMS. Well, it is an area that we do specifically deal with, the inherent conflict of interest that exists, and our bigger concern is making sure that there is an internal control process to manage for and mitigate that inherent conflict.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Senator CARPER. You are welcome.

Senator Reed, you are recognized. Next, we have been joined by Senator Menendez, and, Senator Menendez, once Senator Reed has asked his questions, Senator Bunning will be recognized, and then you are next. Thanks for coming.

Senator REED. Thank you, Mr. Chairman.

Mr. Maurstad, I want to follow up on the Chairman's question about maintenance of these flood maps. We are spending a lot of money, some would argue not enough, but a lot of money to upgrade the maps. But is there a plan of proposed budgets to continue on a regular basis to maintain these maps? And I say that because I think the experience of all of us who live in a coastal State is that because of development, these areas are changing week by week. And without maintenance, we will find ourselves in a few years right back where we started from, where the maps are out of date. Could you comment on that?

Mr. MAURSTAD. Yes, I agree with you 100 percent that we definitely have to make sure as a country that when we are continuing to move forward with the map modernization process that we maintain them far better than we did in the paper environment. One of the benefits of being in the digital world will be that will be easier to accomplish. Funding, of course, will be a concern.

And so we need to look at that. We need to continue to work with providing incentive for State and local governments to partner with the program to make sure that the maps are updated and remain so. But we also need to recognize that over time we are going to have to do this throughout the country over a period of time. With the platform, local communities may be able to do some updating on their own, if they want to take that responsibility over. We will encourage that, to partner with them to do that. So that certainly is an area that needs to occur.

Senator REED. Is there a budget request now for maintenance?

Mr. MAURSTAD. Well, we certainly are working on the budget request for the 2009 budget, but, regardless, the program has, as I indicated before, $55 million that it has been contributing to the mapping process in the past few years, and those funds will still be available from the policyholders. And then we will continue to work with the administration and with Congress on developing the next phase of map modernization.

Senator REED. Ms. Williams' testimony states that an estimated $1.2 billion in flood losses are avoided annually because communities have implemented the NFIP's floodplain management requirements. When did you last update these requirements to provide for these benefits?

Mr. MAURSTAD. Well, essentially that is the requirement that communities adopt the flood maps, that they enforce the floodplain management ordinances that they pass at the local level, and it is associated with new construction, rebuilding, current construction at the base flood elevation or higher. And so we look at the calculation of that benefit on an annual basis. It clearly is and should rise. But the essential base of what the requirements are for the community are the same as what they have been.

I do need to point out that, as you are well aware, there are about 1,700 communities that are a part of the Community Rating

System that represent about two-thirds of the policyholders across the country that go beyond our Federal minimum requirements and do additional mitigation and other activities to make their communities less vulnerable to flooding.

Senator REED. That raises my next question; that is, in Rhode Island, our local authorities have taken, I think, some positive steps. Our Coastal Resources Management Council, for example, has begun to examine the ability of increasing setbacks because of the potential rise in sea levels. We are one of the few States that is looking at that. We have also classified our barrier beaches in the various categories and actually prevented new infrastructures on some of our barrier beaches. The feeling we have is that the community rating service is not giving adequate credit for that, that frankly the standards are so low—it is undifferentiated. There are some States that are doing a lot, some doing a little, but everybody gets treated the same. Can you comment on that?

Mr. MAURSTAD. Yes, sir. There are 17 different categories where Community Rating System participants can gain credit toward the premiums paid by their policyholders. And if you are suggesting—and we will, we will go back and look at those 17 criteria and see if they are weighted appropriately for the types of mitigation activities that you have mentioned. But communities accumulating points, and they start out at a CRS Community 10, can go all the way down to CRS Community Rating 1—we have one of those in the country—and receive at 5-percent increments of policy discounts.

Now, there is another area that is in line with this in that the benefit goes to policyholders, and it has been raised to me before that—and we are looking at whether or not we should provide some type of an incentive or some type of a means for the community directly that takes these activities. And I think that is something that we need to further explore.

Senator REED. Thank you.

Thank you, Mr. Chairman.

Senator CARPER. Thank you, Senator Reed.

Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

We have heard the GAO report released last month found that payments to the Write Your Own companies for servicing policies have ranged from one-third to two-thirds of premium income. What do you think is an appropriate number?

Mr. MAURSTAD. Well, sir, I think that we need to look at that in the context of what we are compensating the Write Your Own companies for, and there are two main categories: One is for their operating expenses, including the compensation for their agents, which is in the range of 31 percent of their written premium. A second part is the—and that has actually gone down a couple of percentage points over the course of the last 10 years.

The second and the factor that has influenced 2006 and is going to influence part of 2007 is what we reimburse the companies for handling claims for the losses that occur. That is a percentage basis also. So as the number of claims increase, as the volume of claims increases, the costs associated with handling that claim is going to increase also.

And so I believe that it is appropriate to look at the operating expense portion of what we compensate and compare that to the premiums, develop the ratio of the premiums that are written, and then I think it is more appropriate to look at the volume of claims and the amount of claims that are paid with the costs associated with that and the ratio there. Clearly, after the catastrophic years that we had, that was a substantial amount.

One of the lessons learned from Katrina is we need to gather information from the Write Your Own companies on their costs to adjust the claims, which we are in the process of doing, and also change the mechanism by which we reimburse the companies for claims. And we are in the process of doing that also. So we are going to make a correction in that area.

Senator BUNNING. This is another question for Mr. Maurstad. In your testimony, you said that the deadline for companies to submit audits for 2005 and 2006 was September 30th. Did all the Write Your Own companies get their audits in on time?

Mr. MAURSTAD. I checked this morning, and they are in the process—we are in the process of determining if all of them—and we are just a couple days beyond September 30. Every indication that I have received so far is that they are going to be in on time. But I do not have the specific number to share with you today. We can provide that to you.

Senator BUNNING. Does somebody else in your shop handle that?

Mr. MAURSTAD. Yes, sir. Again, I asked the deputy——

Senator BUNNING. I would definitely like for you to give the Committee a written report on that.

Mr. MAURSTAD. We will.

Senator BUNNING. No. 2, how much of the claims paid on residential property for 2005 hurricanes went to secondary homes or vacation homes?

Mr. MAURSTAD. I am not sure. I do not have that number right in front of me. But I will provide that to you for the Committee also if you would allow that.

Senator BUNNING. When will the Severe Repetitive Loss Pilot Program rules be finalized?

Mr. MAURSTAD. We are in the final stages of having those rules through the concurrence process. My hope is that in the very near future, we will have that ready to be published.

Senator BUNNING. And what are you doing to enforce mandatory purchase requirements?

Mr. MAURSTAD. Well, the lenders are responsible for the mandatory purchase requirements. We continue to meet with them to make sure, if they have difficulties with that that the program can help with, that we understand what that is and try to assist. But the lenders are responsible for——

Senator BUNNING. What do you mean if you understand it? Is the language in our bill not clear to you?

Mr. MAURSTAD. No. If they understand it. Sometimes the lenders bring concerns to us about the requirements.

Senator BUNNING. Well, if it is not clear, then I would suggest that you come to us and explain what is not clear in the law.

Mr. MAURSTAD. When we meet with our Federal lending partners, I will suggest that to them.

Senator SHELBY. May I?
Senator BUNNING. Go right ahead, Senator.
Senator SHELBY. Is there a penalty in the law for the lenders not to comply, in other words, not to enforce what Senator Bunning is talking about?
Mr. MAURSTAD. They clearly have to enforce, but the question——
Senator SHELBY. No, but what is the penalty if they do not enforce it? They either do or they do not, and it seems like they are lax there. Senator Bunning is onto, I think, a good point.
Thank you for yielding, Senator.
Senator BUNNING. Sure. So you will let us know?
Mr. MAURSTAD. Sir, it is not FEMA's responsibility to enforce the mandatory purchase requirements. It is the lenders' responsibility.
Senator BUNNING. Well, then we will ask them.
Mr. MAURSTAD. Yes, sir.
Senator BUNNING. Thank you.
Senator CARPER. Senator Menendez.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman.
Mr. Chairman, I would ask unanimous consent that my opening statement be placed in the record, along with——
Senator CARPER. Is there objection? Hearing none——
Senator MENENDEZ. Thank you, Mr. Chairman.
Mr. Maurstad, I want to follow up on a question Senator Bunning asked you. Last year when you were before the Committee—I believe it was in January of last year—on the issue of the Severe Repetitive Loss Pilot Program, I asked you then when could we expect the rulemaking process to come to fruition, and you said by the end of 2006, the end of the 2006 fiscal year. I just heard your answer to Senator Bunning, and so I want to ask you a series of questions.
First of all, there was $40 million appropriated for fiscal year 2006. Is that correct?
Mr. MAURSTAD. Yes, sir.
Senator MENENDEZ. And that funding, has that been obligated at all?
Mr. MAURSTAD. That funding has been transferred from the National Flood Insurance Fund into the category that would be available for grants as soon as the program gets up and started. So the funding is there and available.
Senator MENENDEZ. Why is it that, 3 years after the law has been passed, a year after the target date for finalizing the rules, the program is still under development? What is the hold-up?
Mr. MAURSTAD. We attempted to get the rule through the development process and through the concurrence process as quickly as we could, and there really is no excuse that I can offer that is going to satisfy the displeasure with it not being done to this point. All I can indicate to you is we continue to push very hard to——
Senator MENENDEZ. Is this a priority for FEMA?
Mr. MAURSTAD. I believe it is.
Senator MENENDEZ. Boy, if it is a priority, we are in deep trouble if this is the way priorities move.

Let me ask you this: The program is only authorized until 2009, so if it is not starting until next year, what would that mean for the pilot?

Mr. MAURSTAD. It means that the results of the pilot and the effectiveness of the pilot is going to occur beyond that, certainly not—unless the Severe Repetitive Loss Pilot is extended, certainly not before the conclusion of this first phase.

Senator MENENDEZ. Well, it seems to me we are going to have a very limited result of what the pilot would indicate to us as whether it is being successful or not. This is an area—I am particularly interested in this area because my home State of New Jersey, which has 127 miles of Atlantic coastline, was fifth largest last year alone in terms of claims against the National Flood Insurance Program, and has an elevated number of repetitive-loss claims. It is a real concern to us. This program is the one that we anticipate, for example, acquisition, structure demolition, structure relocation, with the property deed restricted for open spaces in perpetuity; where we look at elevation of structures, where we look at floodproofing of structures, where we look at minor physical, localized flood control projects, and a whole host of other things. We cannot get to that if we do not move.

Ms. Williams, what is your assessment of why this program is stuck in the mud?

Ms. WILLIAMS. Over the years, GAO has looked at the implementation of the 2004 act, and in terms of monitoring, getting the pilot up and running, it has been an issue we have continued to raise.

As a concern in terms of a specific reason for it, I do not think I have today a specific reason for why, but we have raised this as a concern, and it is one of the challenges that we acknowledge.

Senator MENENDEZ. You have not studied why, in fact, it has not moved forward?

Ms. WILLIAMS. Other than stating the fact that it has not been moving forward.

Senator MENENDEZ. You know, there are 8,100 properties, as I know it, that are categorized as severe repetitive loss. What is the impact of this in terms of the overall program if we do not get this program moving? Isn't there a cost factor for all the time we delay from making the changes that are envisioned in the pilot program that could look toward mitigation, that would have a savings impact upon the program?

Ms. WILLIAMS. Yes. This is one of the issues that we have pointed out. and it is the fact that the repetitive-loss properties are a drain on the program. These 1 percent of properties account for 25 to 30 percent of the losses.

Senator MENENDEZ. So, Mr. Maurstad, when are we going to see this again?

Mr. MAURSTAD. We are pushing to get it done as soon as possible. If I could add, though——

Senator MENENDEZ. I know, but in January of 2006, you told me at the end of the fiscal year 2006, so, you know, as soon as possible, that is a very open-ended proposition. Can you give me some sense of the timeframe? Can you give the Committee some sense of the timeframe?

Mr. MAURSTAD. I can check with the leadership and try to provide you with a specific date.

Senator MENENDEZ. Would you give it to the Committee in writing.

Mr. MAURSTAD. Yes, I will try to do that.

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. MAURSTAD. Could I add, however, I want to make sure that the Committee understands that no repetitive-loss activity has not occurred. We continue to have the flood mitigation assistance funding available; the individual repetitive loss we got going, that $10 million; plus in the pre-disaster mitigation grant area, many of those applications deal with and focus on repetitive-loss properties. And certainly in the Post-Disaster Hazard Mitigation Grant Program, there are funds that are allocated by the States that they set the priorities toward this issue.

So I do not want to leave the impression that no activity is going on relative to trying to address the Repetitive Loss Pilot Program——

Senator MENENDEZ. But having said that, if that were sufficient, Congress would not have needed to have passed the pilot program.

Mr. MAURSTAD. I understand.

Senator MENENDEZ. Thank you.

Senator CARPER. Mr. Maurstad, I think the history of the program since 1968 is that from time to time revenues that are collected, premiums collected, do not cover the cost of claims, and FEMA has had to borrow money from the Treasury to pay those off and eventually to recoup the money and pay off the loan to FEMA with interest.

As you will recall, we increased here in Congress FEMA's borrowing authority to roughly $20 billion on the heels of the storms in 2005. I would just ask: Is FEMA in a position to repay this debt or begin repaying this debt with interest to the Treasury?

Mr. MAURSTAD. As long as losses are at the historical average, the program will not have the ability to pay the losses, the expenses of the program, and the interest that is estimated to be $800 million a year. Right now, over the course of the next two fiscal year, again, based on the average historical loss level of about $1 billion, a little more than $1 billion, the current borrowing authority of $20.775 billion we anticipate would be exhausted by the end of 2009.

Senator CARPER. How is FEMA currently paying the debt, the interest on the debt?

Mr. MAURSTAD. Well, we have been fortunate. We have borrowed some.

Senator CARPER. From?

Mr. MAURSTAD. From the Treasury.

Senator CARPER. To repay the interest owed to——

Mr. MAURSTAD. Yes. And we have also had in 2005 a less than average historical loss year.

Senator CARPER. 2005?

Mr. MAURSTAD. 2006. Excuse me. In 2006, a less than average historical loss year, so we had cash-flow that was available there to contribute toward the claims of 2005 and the debt, and the same exists so far this year. We will have the final results in probably

60 days, but we are also looking at a lower than average historical loss year this year.

Senator CARPER. All right.

Mr. MAURSTAD. So that has funds that are also made available to repay the interest.

Senator CARPER. Ms. Williams, you discuss in your testimony the problem of properties that are remapped to continue to pay rates based on their previous risk level. You indicated that these grandfathered rates can be permanent.

Does FEMA have the ability to change this policy and charge rates that are more truly based on risk? Does FEMA have the ability to change this policy? And after you have answered, I will ask Mr. Maurstad to respond as well.

Ms. WILLIAMS. I think in terms of legally, it is not clear to us that FEMA has the ability to do this.

Senator CARPER. All right. Mr. Maurstad.

Mr. MAURSTAD. Well, I would say that historically this is in line with the discounts that are provided to pre-FIRM properties, those properties that were a part of the 1 percent annual chance area prior to a community adopting flood insurance rate maps. And so it is consistent with that principle of not adversely impacting property owners as a result of either the community adopting maps or new maps being adopted that changes the floodplain area.

It is also done to make sure that folks maintain their flood insurance during that period of time so that it is in line with, again, the statutory charge of making sure that premiums are affordable.

Senator CARPER. Ms. Williams.

Ms. WILLIAMS. We do not necessarily disagree with any of that, but we raise this issue to point out that it does have implications; that while properties that are remapped may have to face a higher insurance premium going forward, the fact that this particular discounted rate stays in force potentially forever has implications for the program, and those implications have to be considered because it can have an impact on the actuarial soundness of the program, and this is creating another category in addition to the one in five subsidized properties—well, the one in four subsidized properties that already exist.

Senator CARPER. Senator Shelby, did you want to jump in?

Senator SHELBY. I want to follow up on that.

It is my understanding—and you correct me if I am wrong on this. In your written testimony—and you just alluded to it, I think—you suggested that the National Flood Insurance Program is creating a whole new class of subsidized properties you allowing those that are mapped in the newly created 100-year floodplain to obtain insurance less than actuarial rates. Do you believe that FEMA should just now be creating a whole new class of directly subsidized structures if, as I believe and most people believe, one, the Flood Insurance Program is broke, is taking on more, you know, it is taking on, no pun intended, a lot of water? And I do not see any other than really re-engineering the whole program. And I am sure we will hear some of this in a few minutes in the second panel.

Why would they want to take on a new class of directly subsidized structures?

Ms. WILLIAMS. Well, it is kind of—I can't—well,——

Senator SHELBY. Do you see what I am getting at?

Ms. WILLIAMS. I see what you are getting at, and part of it is it is the balancing act that I referred to in terms of you have a community, they are remapped; you have individuals in the community that may now end up in a 100-year floodplain, and they now have a high-risk designation and would have to pay a higher rate.

So in order to keep people in the program, through the FloodSmart process this is being encouraged. People are being encouraged to buy flood insurance today, knowing that their community is being remapped, so they can lock in——

Senator SHELBY. Subsidized insurance, right. Subsidized.

Ms. WILLIAMS. Well, my understanding is for the grandfathered property, the grandfathered rate would be the non-subsidized rate.

Senator SHELBY. Mr. Maurstad.

Mr. MAURSTAD. Well, first of all, it is not a new class. This is something that was occurring in the paper environment also when communities were remapped. So it is not a new class. It is certainly, as we are mapping the entire Nation, more prevalent than what it was when we were not updating the old maps. But they were not a subsidized—they were not a discounted policy—they are not a discounted policy currently.

So what I would like to suggest is if we could provide a written explanation of this process to you for your edification.

Senator SHELBY. Is the program broke?

Mr. MAURSTAD. Well, you know, that is——

Senator SHELBY. By normal accounting standards, is it broke?

Mr. MAURSTAD. The program has more objectives than just financial objectives. If you look at it from——

Senator SHELBY. I am talking about financially. Financially, is it broke?

Mr. MAURSTAD. Financially, it is in debt, and it certainly does not have the ability to repay that——

Senator SHELBY. Is it insolvent, though? That is——

Mr. MAURSTAD. Well, it is not insolvent any more than the Federal Government is insolvent. Because it is a Federal Government program that is backed by the Federal Government, and the whole rating scheme that was developed over the course since 1968 has been one that created the circumstance where a disastrous event would far exceed the program's ability to pay for it. It just took 38 years for that type of an event to occur. It could have happened in year two.

Senator SHELBY. Is the program unable to pay for itself because it was never actuarially sound?

Mr. MAURSTAD. Certainly, it was designed at the beginning for discounts to be provided to pre-FIRM. That is a loss of around $700 million of foregone revenue every year. So the program by design was set up that way.

Now, over the course of time, I think in rough terms in the last decade, the percentage of properties that are discounted has gone from 42 percent down to about 25 percent. The 25 percent of the policies clearly are discounted, and that is why we support removing that discount for vacation homes and for business homes and phasing it out on residential homes.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Senator CARPER. You bet.

I am going to reclaim my time and just ask maybe one more question, and this is probably a question that I would ask of the second panel, too. So this will give them a chance to think about it.

Ms. Williams, you start off your testimony saying, "My testimony today will revisit and update the four major challenges facing the Flood Insurance Program." Then you are going to highlight what those are and then talk about them at some length. Sometimes around here when we are addressing a program that needs to be reformed or revised, we are given the admonition, "Do no harm." So as we go forward on national flood insurance reform, we will certainly endeavor to do no harm.

Give me your short list or to-do list of things that we should do, aside from doing no harm. Then I will ask Mr. Maurstad to respond to these as well. So, Mr. Maurstad, just listen up, please. Thank you.

Ms. Williams.

Ms. WILLIAMS. I think in terms of——

Senator CARPER. What is our to-do list?

Ms. WILLIAMS. Since March 2006, GAO has named NFIP as one of our high-risk programs, so I think one of the first issues would be to deal with the financial solvency of the program and to determine how best to do that.

Next would be to look at the reasons for that.

Senator CARPER. Does that involve forgiving the debt? Is that part of that?

Ms. WILLIAMS. Well, I would think that would have to be part of the debate, given the debt that is owed, the inability of the program to be able to service the debt, while as long as we do not have major flood events, they may be able to pay the interest. If not, any major event would flow directly through to the Treasury, and it would require borrowing from the Treasury to deal with any future significant claims.

Senator CARPER. All right. Keep going.

Ms. WILLIAMS. You know, to deal with that issue, and then to deal with the sub-issues under that, looking at the actuarial soundness of the program. That would involve looking at subsidized and non-subsidized rates in particular.

One of the things we are looking that hopefully will help aid in evaluating this has to do with a review we currently have going on looking at how the actuarial rates are set specifically, whether or not all the zones are actually actuarially sound. So that is where I would start.

Senator CARPER. That is it?

Ms. WILLIAMS. Yes.

Senator CARPER. Well, I want to ask you to think about this and respond to me for the record, if you will, in a more comprehensive way.

Ms. WILLIAMS. Absolutely. All right.

Senator CARPER. That would be very helpful.

Mr. Maurstad, if you will go back to the comments of Ms. Williams, and also just as somebody who has thought a lot about this program, given the responsibilities you hold, what should we do as we go forward?

Mr. MAURSTAD. We need to increase the percentage of policyholders paying actuarially sound rates by phasing out the discounted premiums.

Senator CARPER. OK.

Mr. MAURSTAD. We need to increase NFIP participation, incentives, improve program enforcement, have sound oversight. We need to work diligently and incorporate a greater participation by all of the actors involved in making sure that communities understand their risk, that property owners understand their risk, and they take appropriate action, so communication.

And I think we need to continue to further reduce risk through mitigation practices. We need to focus on the repetitive-loss properties. We certainly need to continue sound progress in mapping and continue that into the future. And I think there needs to be a broader discussion of the impacts of areas that are protected by levees and dams and how that affects what people believe their risk is, how safe they are, and how the program reacts to that, both from a floodplain management perspective and proper insurance rating.

Senator CARPER. Good. Thanks. That is the kind of list we are looking for.

Ms. Williams, if you would expand on your answer for the record, that would be appreciated.

Ms. WILLIAMS. Yes.

Senator CARPER. Senator Shelby, any last word?

Senator SHELBY. No. I will wait for the next panel.

Senator CARPER. OK. We will probably have some additional questions for you, and we just ask that you respond to them promptly. We appreciate very much your being here today. Thank you.

As the members of this panel take their seats, Mr. Berginnis, go ahead and pull up a chair. Your name is pronounced "Berginnis." Is that correct?

Mr. BERGINNIS. Yes, sir.

Senator CARPER. And are you from Ohio?

Mr. BERGINNIS. Yes.

Senator CARPER. Where do you live?

Mr. BERGINNIS. In Newark.

Senator CARPER. OK. I was back at Ohio State. I am a graduate of Ohio State. I was back there about 10 days ago and saw, among other things, my old Navy ROTC unit and my old fraternity house, and the first quarter of the Ohio State-Northwestern football game where they scored 28 points. It was quite a beginning. I was there in 1968, the year that the National Flood Insurance Program began, the year that Ohio State did pretty well on the football field, as I recall. So you are going to lead off this panel, and you are the State Hazard Mitigation Officer of the Ohio Emergency Management Agency. You are going to be testifying here on behalf of the Association of State Floodplain Managers. Welcome. Thank you.

Senator SHELBY. Can I say something?

Senator CARPER. Sure. Go ahead, please.

Senator SHELBY. I was thinking of Ohio State. You know, we love their brand of football, great school and everything. But every now and then they run into the SEC teams from the South. But not every day. They are holding on, to say the least.

Thank you, Mr. Chairman. I will pay for that.

Senator CARPER. All right.

[Laughter.]

Dr. Galloway, Dr. Gerald Galloway—well, let me go back to Mr. Griffin here. You are listed out of order in my—you are fine. You can sit right where you are, but I understand you are with the Property Casualty Insurance Association of America. Is that correct?

Mr. GRIFFIN. Yes, sir.

Senator CARPER. We are delighted that you are here. Thanks for joining us.

Dr. Gerald Galloway, Professor of Engineering at the University of Maryland, a Terrapin.

Mr. GALLOWAY. Yes, sir.

Senator CARPER. Welcome aboard.

We have J. Robert Hunter, Director of Insurance for the Consumer Federation of America. Thank you for joining us today.

Vince Malta.

Mr. MALTA. Good afternoon.

Senator CARPER. I am going to go back to Mr. Davey, President and CEO of Fidelity National Insurance.

And last, but not least, Vince Malta from the National Association of Realtors. Mr. Malta, welcome. We are glad you have come, and we are just going to recognize you to speak. My staff has given me a notice that says let's cut your testimony back to 4½ minutes, let's not take the full 5 minutes. We will probably close you off right around 5 minutes, and then we will go right to questions.

Mr. Berginnis, welcome. O-H.

Mr. BERGINNIS. I-O.

Senator CARPER. There we go.

Mr. BERGINNIS. And, yes, the SEC has been giving us problems recently.

STATEMENT OF CHAD BERGINNIS, STATE HAZARD MITIGATION OFFICER, OHIO EMERGENCY MANAGEMENT AGENCY, ON BEHALF OF THE ASSOCIATION OF STATE FLOODPLAIN MANAGERS, INC.

Mr. BERGINNIS. Good morning, Chairman Carper and Ranking Member Shelby and distinguished Members of the Committee. I am Chad Berginnis, Past Chairman and Mitigation Policy Coordinator for the Association of State Floodplain Managers, and also a day-to-day practitioner implementing these FEMA programs, the National Flood Insurance Program as well as the Hazard Mitigation Programs.

Today the ASFPM is pleased to offer our thoughts on a program that has for nearly 40 years served the Nation quite well. The NFIP was and continues to be a unique program having three components—flood insurance, flood mapping, and flood mitigation—that meets simultaneous goals of risk reduction, easing the dependency on taxpayer-provided disaster relief funds, and distributing the responsibility for floodplain management to all levels of Government.

While the Congress has held numerous hearings since Katrina exploring ways to improve the NFIP, we hope you give consideration to the following items:

First, the program was praised by Members of Congress for quickly and efficiently handling claims, although recognizing the financial issues that we are dealing with. Large-scale recovery mapping efforts have resulted in updated information on flood risks, which is essential to recovering in a way that is more resistant to destruction next time a hurricane would occur, and flood mitigation elements of the NFIP such as construction codes and increased cost of compliance have the potential to transform the area to one that is less flood-prone, more resilient to future disasters, and potentially eliminate a large number of the repetitive-loss properties that were discussed earlier and that continue to be a significant challenge for the NFIP.

We sit here in support of NFIP reform, and I would best characterize ASFPM's recommendations as a pragmatic approach, addressing all components of the NFIP, and one that is based on studies, evaluations, and supporting the original intent of the program.

On the issue of flood insurance reforms, we believe that reforms must lead to a better financial stability while balancing the need for policy affordability. We hear it all the time out in the field, the price of flood insurance policies. ASFPM supports moving rates to actuarial for pre-FIRM non-residential buildings and non-primary residences, and also believes that the mandatory purchase of flood insurance should be extended to areas protected by flood control structures. These areas still have flood risk, and while it may be lowered by the mere presence of those facilities, the catastrophic consequences of failure are much higher than if the structure did not exist at all. These policies would be, I would anticipate, lower in cost also than those in the 100-year floodplain.

The extending of mandatory flood insurance purchase to non-federally regulated lending entities, allowing escrow of flood insurance premiums and debt forgiveness, are also supported by the ASFPM.

Flood mapping reform must acknowledge the ongoing need to update and refine the Nation's flood hazard maps. The proposed National Flood Mapping Act of 2007, introduced by Senator Reed, not only recognizes this, but also recognizes that our flood maps should identify the multiple flood risks that we face, whether it is in areas protected by levees, 500-year floodplains, or even storm surge inundation areas.

Investments in flood mapping should be concentrated on the flood data layer and strive to map the full extent of the 100-year floodplain updating older, outdated hydrologic studies that, again, the Committee had recognized previously.

In Ohio, for example, States investments in statewide LIDAR, which is a laser-based topographic mapping, will result in extremely accurate topography that can be used to further refine flood hazard maps.

Flood mitigation reform should build on the successes and challenges of past reforms in 1994 and 2004. In particular, we propose changes to the Flood Mitigation Assistance Program and increased costs of compliance coverage to make them more flexible in mitigation options allowed and costs that are eligible to be covered. We are concerned that the repetitive flood claims program, as it has been designed, does not necessarily meet the congressional intent and are also particularly concerned that the Severe Repetitive Loss Program has some potential statutory issues that have made it very difficult to implement in rulemaking. We would request the Committee invite FEMA to discuss those issues and barriers to implementation, and recommend also that the pilot program be extended to preserve the 5-year intent.

Finally, we must guard against reform proposals that weaken the NFIP. There have been a lot of reform proposals talked about, certainly in the House as well, and proposals to do such things as opting out of buying insurance or providing insurance in communities that refuse to join the NFIP. Those communities that refuse to do the day-to-day management responsibilities of their flood hazard area will weaken the NFIP. Perhaps the most disconcerting of these proposals, though, is the addition of wind coverage to the NFIP. ASFPM is strongly opposed——

Senator CARPER. Mr. Berginnis, I would just ask you to go ahead and finish this sentence, but then wrap it up, please.

Mr. BERGINNIS [continuing]. To this proposal, and especially in light of the need to strengthen the NFIP's financial standing and maintaining price affordability.

Thank you.

Senator CARPER. Thanks very much for your testimony.

Mr. Griffin, you are recognized for 5 minutes.

Mr. GRIFFIN. Thank you. Mr. Shelby, I do not know whether you remember. You spoke a few years ago at the National Association of Realtors, and I was on a panel on insurance following that. And nothing like the topic of insurance to clear the room. You had a full room of people, probably 300 or 400, and as soon as our panel came up, it looked similar to the way it does here today. So, anyway, I hope you will not hold that particular comment against me.

[Laughter.]

Senator SHELBY. So you are used to it, right?

Mr. GRIFFIN. I am used to it, yes. It is a popular topic.

STATEMENT OF DONALD L. GRIFFIN, VICE PRESIDENT, PERSONAL LINES, PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

Mr. GRIFFIN. My name is Don Griffin, and I am Vice President of Personal Lines for the Property Casualty Insurers Association of America. PCI is a trade association representing over 1,000 insurers, and 57 of the 88 insurers are in the NFIP's Write Your Own program. Thank you, Chairman Carper and Ranking Member Shelby and Members of the Committee for the opportunity to appear before you today.

I will probably jump to the end of where you asked for recommendations because that is what most of my testimony will focus on.

PCI believes that the NFIP is a necessary public policy response to an uninsurable peril. It has undergone significant changes throughout its history, yet it still provides vital, important protection for our Nation's policyholders. However, the program as currently structured does not provide consumers with the level of protection needed and has not achieved the participation needed.

The events of 2004 and 2005 have shown the devastation by hurricanes and floods that can impact millions of lives, businesses, and our Nation. Even as those hardest hit continue to rebuild, scientists tell us we are in for a period of a lot more of this coming along the road. So we need to be better prepared.

Significant reforms were passed in 2004. Unfortunately, many of those reforms were not in place when the 2005 hurricanes hit. They are now. We believe that those things will be helpful in the future.

Also, as you have heard from many of the people that have talked—and you are well aware—the debt that the Federal Flood Program is carrying right now is huge. We think there is room for improvement on all fronts.

So what do we think should be done with the National Flood Insurance Program? First and foremost, we think the debt should be forgiven. We do not see any way possible that the National Flood Insurance Program is going to be able to repay this debt based on the current rating structure. The program should be reauthorized for a long-term basis. In order to reduce litigation, you should affirm the Federal court jurisdiction over all disputes relating to the procurement and the policy adjustment and claims related to the NFIP.

The program should include enhanced mitigation efforts and strong building codes. We need to look at land use. We cannot continue to put ourselves in harm's way. As all of us would like to live along the coast, that is just not possible, even though 54 percent of the population does already.

The maximum coverage limits should be increased to at least allow the average home to be replaced based on today's construction costs.

FEMA should be given more flexibility in determining rate changes and as well charge actuarially sound, risk-based rates for all properties.

The policies should be rewritten so it is more closely aligned with the homeowners' policy and the other P&C products that are out there today. The program should include at least some coverage for additional living expenses, business interruption coverage, and the option to insure buildings for their replacement cost value. The program should provide more educational materials and strengthen requirements for flood protection.

The flood maps are outdated. It has been mentioned many times here already today. And, oftentimes, as a former agent, I can tell you it was an awful hard thing to try and figure out where the property was on that flood map. So reform legislation needs to include additional funds to complete the map modernization initiative and to expedite that process.

We all have a duty to provide consumers with the best information possible so that they can make an informed decision. Unfortunately, when it comes to flood insurance, many consumers take a look at this and figure it just will not happen to me, so if they are not required to buy it, they do not.

The program should include, therefore, the mandatory purchase requirement, and it should be expanded to include additional properties at risk and properties that are located behind levees or other protective barriers. Mandatory purchase requirements should not be limited to those areas in special flood hazard areas.

The program should encourage lenders to establish escrow for policies outside those 100-year floodplains so that people can better afford the product and purchase the product.

Again, thank you for the opportunity to be here and present our views. We commend you and the Committee for actually looking at this issue, and we look forward to working with you to improve it and make it better in the future.

Thank you.

Senator CARPER. Mr. Griffin, thank you, and thanks so much for the way you structured those recommendations. That was very helpful.

Dr. Galloway.

STATEMENT OF GERALD E. GALLOWAY, PH.D., PROFESSOR OF ENGINEERING, UNIVERSITY OF MARYLAND

Mr. GALLOWAY. Thank you very much, Senator Carper, Senator Shelby. Delightful to be here today. I am a Professor of Engineering with the Terrapins at the University of Maryland, but I come today as the former PI of a study of the adequacy of the 1-percent standard we have in the NFIP, and having just finished a Levee Policy Review Committee session for FEMA. I also led the 1994 White House study of the reasons for and what should come out of the Mississippi floods of that particular period.

I am here today to urge the Committee to extend the zone for mandatory purchase of flood insurance from the 100-year flood zone to the 500-year flood zone. Requiring insurance only within the 100-year floodplain does not provide coverage for the 3 to 7 million structures at risk in the floodplain in that 100- to 500-year zone. Requiring actuarially sound and location-based insurance for those in this zone would not impose significant financial burdens on property owners at risk in this latter zone, as it is considerably less than the risk in the 100-year zone, but it would greatly reduce the exposure of the Federal Government and certainly the residents to losses from a significant event that could occur. As we learned in New Orleans and in earlier floods, levees do fail, and I recommend the extension of the mandatory purchase of insurance to include areas behind levees and to require FEMA to accredits levees in the NFIP only when they are at the 500-year level and protect urban areas.

Many of the structures that we now have protecting millions of Americans are of unknown or marginal integrity. Requiring those behind levees to obtain flood insurance informs them of their risk, reduces the impact on these individuals should a flood occur, and limits the exposure, again, of the Federal and State governments in terms of the assistance and indemnification they must provide.

For over 25 years, studies have emphasized that the 100-year levees do not provide sufficient protection for areas where large numbers of people or high-value property are at risk. A 100-year levee faces a 26-percent chance of being overtopped within the life of a 30-year mortgage. Not very good odds.

Finally, I urge the Committee to support continuation of the Flood Map Modernization Program and the ongoing shift of emphasis from flood rate mapping to flood risk mapping. The key to effectively dealing with the flood hazard is to know where it is and how bit it is and what the consequences of a flood event might be.

The Map Modernization Program has been a major step forward, but it has a way to go. While we have made progress in developing more accurate topographic data for use in mapping—you have referred to that already, and my colleague has talked about the advantages of LIDAR—unfortunately, much of the Nation's hydrological data are out of date. Approximately 45 percent of levee designs and flood risk determinations are based on precipitation frequency estimates that are as much as 45 years old. Approximately the same percentage of designs and determinations are based on flow frequency guidelines that are at least 25 years old. Many communities even lack long-term stream flow records. Support of map modernization must provide for updating this hydrologic data and must also address the needs of NOAA and USGS for funding of needed data collection and monitoring. We also need to take a strong look at including future conditions in this mapping.

A flood insurance rate map, however, is not a risk map. Risk analysis incorporated information about the hazard, the probability of the system—levees, flood walls, flood ways—may not perform as designed, and the consequences that will occur should the flood exceed the level of protection provided or should the system fail.

Describing a risk on a map is not a simple process, but one that must be accomplished if the public is to know and understand the challenge it faces living in a flood zone. The Corps of Engineers, in cooperation with FEMA, has been working diligently in the New Orleans area to develop various types of flood risk maps and recently published maps that indicated the depths of inundation in various areas of New Orleans should certain floods occur. These maps take into account the potential performance of the levees and other structures that are part of the flood damage reduction system. I have got copies of these that are in my testimony and larger copies I have up—if someone would hand those to the Senators, I would appreciate it.

S. 1938 indicates that risk must be considered in the mapping process. The language of the bill provides an important endorsement of this need. FEMA and the Corps have worked closely together on the mapping of New Orleans and are working together in California. They have also become partners in the development of a national levee inventory. This cooperation has brought the resources of both agencies to bear.

In closing, let me compliment the Committee on its attention to the issues of floodplain management. The proposed legislation on flood mapping provides strong support for continuation of a program that is critical to our efforts to reduce national flood losses and to protect the health and safety of our citizens.

Thank you.

Senator CARPER. Dr. Galloway, thank you very, very much.

Mr. Hunter, you are recognized.

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

Mr. HUNTER. Thank you, Mr. Chairman, Mr. Shelby. The Flood Program is a shambles. Two of the key problems are that the program is currently subsidizing unwise new construction in the Nation's floodplain, and the administration is out of control. Congress wisely established the program on the principle that new construction would not be subsidized, and now I am hearing even grandfathered subsidized.

When I ran the program, we had a goal of updating maps every 3 to 5 years. Now they are 20 years old, some of them. All maps are biased to the very low side because there is a lot of construction going on. Now, maps with elevations that are too low do a lot of bad things. People build new homes they think are safe that are not. Rates are predicated upon the elevations that are too low and, therefore, are actually subsidized. The hidden subsidy. People buying homes in what they think are outside the floodplain do not buy flood insurance, but they really are in the floodplain.

FEMA is not following through to make sure that communities are enforcing even these inadequate maps. Congressional intent of not subsidizing new construction has been thwarted. FEMA's program administration is out of control. GAO reports, two of them recently, one is that the fees that they are paying to the Write Your Own companies, they have no idea what they are. Some partnership. One partner gets all the assets; the other gets all the liabilities, $3.2 billion in the last 3 years paid to the Write Your Own companies, more than half of the premiums.

Despite the cost, the conflicts of interest are failing consumers and taxpayers around the country. Just look at the Gulf Coast. After Hurricane Katrina, judges have found that insurance companies are engaged in illegal cost shifting that was adverse to the flood program. One Write Your Own insurer assigned $95,000 in flood damage to a property that never flooded. Other adjusters say that one insurer is charging the flood program much more for building materials for flood repairs than they do for the same house for wind damage. FEMA does not know if what they are paying—if these claims are being properly paid or not because they do not have the right information.

The Flood Insurance Program Write Your Own companies are using anti-concurrent causation clauses in their policy that basically says if a flood happens at the same time as wind, we are not going to pay any wind, making it much more probable that flood damage will be magnified in the adjustment.

Can solvency be achieved for flood insurance? Not under the current administration. The subsidy Congress built into the program was there for a reason. It made sense at the beginning. The subsidy was intended to help people, rich or poor, who had built prior to the flood maps being in place and might not have realized there was a flood risk. Thirty years have passed since those maps were in place. In retrospect, the program should have phased the subsidy out from the beginning and as homes were sold, since the maps were then available, and over time these subsidies should have been reduced and eliminated. Grandfather rates, of all things, should not be kept in place forever and should be eliminated.

Now, obviously subsidies for low-valued structures for poor people have to be handled with great care and done over a period of time, and that requires some thought about it. But the recent CBO report makes it clear that most of these are not low-valued structures. These are rich and frequently, 23 percent of them, second homes.

So what should Congress do now? First, it would be irresponsible for Congress to expand the program while the program is out of control. The main reason CFA has opposed House bill 3121 is that it expands coverage without controlling the costs.

In the last session of Congress, this Committee reported to the floor S. 3589, which, unfortunately, did not pass, but it did very positive things, including focusing on the critical need to reduce subsidies quickly, building reserves for future losses, studying excessive expenses paid to Write Your Own insurers, and other things.

It is a very good place for you to start your consideration on improving the National Flood Insurance Program. Removing more of the subsidy, as we outline in our written testimony, we think could even strengthen the bill some more.

Three critical steps must be taken to make the NFIP work properly. They are straightforward: make sure that mitigation works, move to actuarial soundness, and restore sound management of FEMA. Since FEMA seems unable to do this itself, Congress must undertake tight oversight of FEMA's implementation if these goals are to be achieved.

Senator CARPER. Terrific. Thanks very much.

Mr. Davey, 5 minutes, please.

STATEMENT OF MARK DAVEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FIDELITY NATIONAL INSURANCE COMPANY

Mr. DAVEY. Thank you, Mr. Chairman, for allowing us to participate in this hearing on further enhancing the National Flood Insurance Program. Fidelity National Property and Casualty Insurance Group is the largest writer of flood insurance policies in the United States. We wrote 338 million NFIP policies for the calendar year 2005, approximately 400 million for calendar year 2006, and we are on track to produce in excess of 430 million for calendar year 2007. Sixty-five percent of our current flood policies are in mandatory coverage areas where 35 percent of our policies are in voluntary, non-mandatory flood zones.

Mr. Griffin has set forth in his testimony a number of suggested reforms to the program, and Fidelity National strongly supports those changes. I have included in my written testimony a number of additional improvements to the program that we may suggest be made to ensure its continued value for American homeowners. We must modernize this program and re-establish it on a more financially sound foundation. The key to doing so is to increase participation in this program, bringing more dollars in, and provide a higher level of protection to families across America.

One of the reforms that was discussed in crafting last year's legislation was a significant reduction in expense reimbursements. That discussion is likely to be renewed in the wake of last month's GAO study. I believe that the study seriously misrepresents the expense reimbursement issue, and I would like to address those misrepresentations.

Upon first reviewing the GAO report, I was immediately disappointed reading their claim that payments to Write Your Own insurance companies comprised up to almost two-thirds of total premium revenue. The science of statistics is one of our most powerful analytical tools available today; however, statistics that are quoted and utilized out of context are destructive, and incorrect inferences can cause substantial damage. The utilization of individual data components to validate the above-referenced statement is factual, but when taken out of context, it is extremely misleading.

The claims administration fees and adjusting fees cannot be disregarded when examining this period. As the GAO report states, "Prior to the unprecedented events of 2005, the NFIP was self-sustaining." Relatively speaking, I would argue that the program prior to 2005 was efficiently fulfilling its mandated costs in a fiscally responsible manner.

Hurricane Katrina not only highlighted the need to examine specific components of the NFIP; it also forced policymakers, businesses, and individuals to rethink an extremely broad range of practices and policies. Relating to the NFIP claims funding and administration process, we need to analyze the basic funding mechanisms and administration models to properly and adequately respond to future events on a Katrina level.

The GAO report acknowledges that Write Your Own carriers did close 95 percent of all claims resulting from Katrina, Rita, and Wilma by May of 2006, within 9 months following the event.

I can only speak in regards to our NFIP policyholders. I feel we qualify and administer our claims per prescribed guidelines to the very best of our ability. I know we had one of the largest claim loads of all Write Your Own carriers, and I am proud of the response we provided to our customers. We did everything possible to make certain we assisted our customers while strictly adhering to NFIP's prescribed claims handling processes and policy provisions. We take our fiscal responsibility to the Federal Government very seriously.

I am troubled by the tone and inference made in some sections of the report. We followed set protocols to the letter and individually examined each and every claim on its own merit. To the best of my knowledge, every dollar paid for flood damage went toward actual documented flood damage. We were good fiduciaries of the Federal Government's money and should not be faulted for following protocol in receiving the provided administrative fee as prescribed by FEMA.

Based on the Hurricane Katrina experience, we believe the claims administration fees should be reviewed for storms of this magnitude. As CEO of Fidelity National, I stand ready and willing to participate in your review process to make the NFIP a better program for non-cat times and truly catastrophic times.

Mr. Chairman, thank you again for your time today. I look forward to answering any questions you may have and to help reform this valuable program.

Thank you.

Senator CARPER. Mr. Davey, thank you.

Mr. Malta, you have the last word.

STATEMENT OF VINCE MALTA, NATIONAL ASSOCIATION OF REALTORS ®

Mr. MALTA. Good afternoon, Senator Carper, Senator Shelby, Members of the Committee. Thank you for inviting me to present the views of the National Association of Realtors on the National Flood Insurance Program.

The NFIP enables property owners in participating communities to purchase insurance as a protection against flood losses. More than 20,000 communities participate in the NFIP. According to FEMA, flood damage is reduced by nearly $1 billion a year as the result of communities implementing sound floodplain management requirements and property owners purchasing flood insurance. NAR encourages efforts to reform the NFIP that will, No. 1, ensure that flood maps are accurate and up to date; two, address the NFIP's ability to pay existing and future obligations to policyholders; and, three, educate consumers about the importance of obtaining and maintaining flood insurance.

In addition, reform efforts should strike a balance between ensuring the long-term fiscal viability of the NFIP and avoiding changes that may result in market inequities and housing affordability problems, especially for low- and moderate-income homeowners and renters.

First, regarding flood maps, without accurate maps, property owners are not able to properly evaluate the risk to their property from flooding. NAR has been, and will continue to be, a strong advocate of fully funding the map modernization program. To this end, we are working with the Flood Map Coalition to secure full funding for the map modernization effort, with groups such as the Association of State Floodplain Managers.

NAR is concerned, however, that adding a requirement to map the 500-year floodplain—a task much larger than updating the existing 100-year floodplain maps—as part of FEMA's Map Modernization Program could lead to delays in updating the 100-year floodplain maps. Realtors do not want to see this process delayed further.

Next, regarding the NFIP's financial stability, there are a number of policy options to address the NFIP's financial stability that would have the support of realtors and others that we suggest Congress to consider carefully.

First, NAR supports policies and reforms that would limit the drain on the NFIP posed by severe repetitive-loss properties. In addition, NAR supports funding for mitigation activities for individual repetitive-loss properties and extending the pilot program for mitigation of severe repetitive-loss properties.

Second, increased participation in the NFIP. Flooding from recent hurricanes in the Gulf Coast as well as in North Carolina has made clear that many vulnerable low-income families have virtually no flood coverage. Therefore, NAR encourages the Committee to include a study in its NFIP reform bill that will identify ways to increase low-income family participation in the NFIP and identify ways to ensure that a greater percentage of at-risk homeowners and renters are able to protect themselves from future flood losses. We believe that any such study should include an analysis of how best to encourage renters to participate in the NFIP because they, too, are at risk and eligible to purchase content insurance.

In regards to subsidies, NAR strongly encourages the Committee to commission a study of the effects of phasing out subsidies before including such a proposal in legislation. Eliminating subsidies on non-primary residences and non-residential properties could have significant unintended consequences for renters, business owners, potential homebuyers, neighborhoods, and local economies.

Despite rhetoric to the contrary, a recent CBO report on the NFIP noted, and I quote, "the evidence here does not suggest that the subsidies tend to cover larger or more luxurious structures, whether inland or in a coastal area." The National Association of Realtors is concerned that eliminating subsidies would result in higher flood premiums, increase the cost of property ownership and rents in these areas, and could lead to increasing delinquencies, foreclosures and reduced property values.

Third, educating consumers. This is essential to help protect against future loss from flooding. Many consumers may not be aware that flood insurance is available to them, especially if they live outside a high-risk flood area. NAR has been working with FEMA to develop educational materials for realtors, clients, and potential clients about the importance and availability of flood insurance through the National Flood Insurance Program. These materials should be finalized later this fall.

Thank you again for inviting me to present the views of the National Association of Realtors. NAR stands ready to work with the members of the Committee and all Senators to enact meaningful reforms to the National Flood Insurance Program.

I would be glad to answer any questions that you may have. Thank you.

Senator CARPER. Thank you, Mr. Malta. I have a couple of questions I am going to ask, and I will submit a number for the record, and I know Senator Shelby has indicated he has as well.

Senator Reed handed me a question to ask as he walked out of the room, and let me just truncate it by simply saying Mr. Malta has raised some concerns about mapping the 500-year floodplain. Just by a show of hands, are there other witnesses at the table who share the concerns that Mr. Malta has expressed. If you would just raise your hand.

[No response.]

Senator CARPER. OK. Let me come back to Mr. Berginnis, if I could. Mr. Berginnis, the American Institute for Research conducted—at least I am told they conducted an extensive evaluation of the Flood Insurance Program, and they made numerous recommendations for strengthening the program. I would like to read one quote on removing subsidies. Here is what they had to say:

"It appears that, given the NFIP's current financial position since Hurricane Katrina and given the volatility of flood-related losses, pursuing actuarial soundness as a primary goal could undermine other goals and increase net costs to society."

Now, in the bill this Committee passed last year, we attempted to balance the need to move to actuarial rates with the other program goals—that is, mitigation and protection—by removing subsidized rates from non-primary residences, such as vacation homes, as well as severe repetitive-loss properties. Could you comment for us on whether you believe this bill—I guess it was last year's bill—struck the right balance and what the effect might be if we removed all homes—if we removed all homes to actuarially sound rates?

Mr. BERGINNIS. Thank you for the question. Last year's bill did take a measured approach in terms of selectively reducing subsidies. It clearly did not have a blanket approach, but there were—if I recall, one of the provisions that within ASFPM we discussed quite in detail was the movement toward actuarial rating in the event of a property buying or selling a property transaction where it would actually move to actuarial rating. And for things like secondary homes, vacation homes, those are kind of no-brainers. But when you actually tie movement to actuarial rating when a real estate transaction occurs, again, I think some of the problems that were identified earlier, real estate transactions happen between rich folks or poor folks and everybody in between. And there is a need to strike that balance, especially with lower-income people, moderate-income folks even, to move very quickly toward actuarial rating.

I do not know—it was—hearing Mr. Hunter, and certainly talking about we need to move to that, the conundrum of moving everything to actuarial rating is really dealing with primary residences and how in the heck you get your arms around that issue and move those toward actuarial rating.

In general, ASFPM has always advocated an approach where we move toward actuarial rating but also come in on the back side with mitigation options and programs to where folks would at least have an opportunity to mitigate and make their house in a better position.

Senator CARPER. Thanks. I do not know if anyone else would like to respond to that same question. If you would, have at it. Mr. Griffin.

Mr. GRIFFIN. Sure. I think that one of the things that we have to be cognizant of is that transaction and that not all the people that live in coastal areas are wealthy. So I think one of the things we have to do is when we move, as you have proposed last year, to actuarially sound rates in certain areas of the country and under certain circumstances, we need to make that happen. But we also need to look at it for primary residences and perhaps on a more gradual basis.

The idea is that we need to get this program on sound financial footing, and if we have to do that over a period of years, that is fine with our industry. But we need to make sure that that does happen.

Thank you.

Senator CARPER. Thanks.

Anybody else? Dr. Galloway and then Mr. Malta.

Mr. GALLOWAY. Just very quickly, in the follow-up to the Mississippi flood and other riverine floods as opposed to coastal floods, it has been amazing to see that a large number of the people that are affected are low-income retirees, people who have lived in the home their entire life. And in the 1994 study, following up by others, we came up with the obvious conclusion that if you are going to go to actuarial rates and you are going to raise the rates, you will have to provide some sort of a safety net. And in dealing with the Government, when the administration was dealing with that, they felt that that could be accomplished.

Senator CARPER. All right. Thank you.

Mr. Malta, the last word on this, and then I will ask one more quick question and then hand it over to Senator Shelby.

Mr. MALTA. Yes. As pointed out, this is not just an issue about big houses on the beach. This is about working-class families that live along rivers and streams, et cetera, as has been pointed out here earlier.

Senator CARPER. Thanks.

My last question, at least for the record, would be for Mr. Griffin. Mr. Griffin, I think you indicated in your testimony that half of those that are required to carry flood insurance do not purchase flood insurance. Let me just ask: What can be done to get more people to purchase flood insurance?

Mr. GRIFFIN. I think there are a couple of things. I think, first of all, we need to make sure that the public is more aware of the requirement. I think that what has happened, unfortunately, in our society as we moved to the secondary mortgage market where a lot of times mortgages change hands, sometimes the requirement to purchase that flood insurance somehow gets lost in the transition, so we need to make sure there is enforcement there. I think the communities need to be more involved in making sure that the people do that and that actually need to buy it.

The Rand report is what I was referring to as the one that did a study and indicated that about 50 percent—in effect, I think in New Orleans only about 39 percent of the people who actually lived in New Orleans had proper flood insurance, and that is not an acceptable take-up rate as far as the industry is concerned or as far as we think the Government is concerned. So I think we have to do better, and we have to make sure that the public understands that this is more of a requirement and not just a—"Does my mortgage lenders require it?" is typically the question. And sometimes I think they forget or a couple years later somehow it falls off.

But the question also is: If the mortgage lender does not require it, then oftentimes the answer is, "I am not going to purchase it."

Senator CARPER. Fair enough. All right. Thank you.

Senator Shelby.

Senator SHELBY. Mr. Chairman, I have a number of questions that I would like to submit for the record because we do have two conferences that meet on Tuesdays.

Mr. Hunter, I just want to make an observation. You have been here many times. You know this program.

Mr. HUNTER. Yes, sir.

Senator SHELBY. You ran this program.

Mr. HUNTER. Yes.

Senator SHELBY. And I appreciate very much your observations regarding this program, candid, very candid. But unless we, one, have proper mapping—which goes to Dr. Galloway's statement—proper mapping and a broad influx of new people in this program, this program is going to continue to take on water, is it not?

Mr. HUNTER. Yes. You need proper mapping, proper rates.

Senator SHELBY. Right. Proper mapping and proper rates.

Mr. HUNTER. And penetration.

Senator SHELBY. And penetration. In other words, I see no reason in the world—in the world—for the taxpayer, the rest of the people in this room here, for example, to subsidize me or my friends that have their second homes at the beaches and flood-prone areas.

Now, I do see from a social program that where you have the primary homes of the less fortunate, we can devise some type of program. But why should we in any way subsidize very wealthy people in this country? And that is what we are doing, is it not?

Mr. HUNTER. Yes, you are, and obviously there is a mix of demographics. But I think you can come up with a program. I think in retrospect, now looking back to the beginning, it is too bad we did not at the very beginning say we are going to phase this out over time. But if we do not do it now, we will be sitting here 30 years—I will not, but some people will be sitting here having the same discussion.

Senator CARPER. Well, Senator Shelby might still be sitting here. [Laughter.]

Senator SHELBY. Senator Carper might be here in 30 years, but I do not think that I will be here, either.

Dr. Galloway, in your written testimony, you pointed out several flaws of the ongoing FEMA Map Modernization Project, including the fact that FEMA often simply makes a digital copy of an existing paper map and that the underlying data used is still extremely dated information. In other words, there is nothing new here. You are just repeating the mistakes. You also stated that more coordination within the Federal Government will be useful.

Could you highlight for the record the nature of your concern and provide the Committee any recommendations for your consideration as we move forward? We heard FEMA testify a few minutes ago—you did, too—and GAO. We are not satisfied with that. We see this program, as Mr. Hunter would say, it is broke, and it is going to become "broker"—if you can get "broker." And I do not see any way to modernize this program if we do not phaseout the subsidies for most people and, second, if we do not have proper mapping. Or maybe mapping comes first.

Mr. GALLOWAY. I would say that in many ways the Flood Map Modernization Program has represented an unparalleled amount of cooperation among Federal agencies. The problem is they are trying to recover 25 years of neglect. The very fact that we have not updated our weather maps, the very fact that the information on which FEMA must rely is out of date, makes it very difficult to start. And getting money into other programs is almost impossible.

What you have seen in the map I left you on New Orleans says that we are beginning to see——

Senator SHELBY. That map is scary, if you look at it.

Mr. GALLOWAY. It scares you, and that goes to the issue of penetration. If a map like this is hung on the wall in a community and they know what the potential flooding is, then they will be able to do something. There are steps that can be taken. It will require continued support of the Map Modernization Program, adequate funding, and an emphasis on this cross-agency cooperation.

Senator SHELBY. Doctor, you heard the testimony I alluded to earlier from FEMA that said they can map things and then they have to go through the local people to see if this is what they want to do and everything. Is that a problem?

Mr. GALLOWAY. Well, I think it is the challenge. The system is designed to give the local community, as it should, a voice in the project. When the local community is not interested, it becomes a struggle for FEMA.

Senator Dole pointed out that North Carolina is charging ahead because they are a local cooperating partner, and North Carolina has spent money on getting the maps, is interested in having that information. But when other communities are not, it makes it very difficult for FEMA.

Senator SHELBY. Well, you obviously know this, but in my State of Alabama, we have two large counties—Mobile and Baldwin—on the coast, and I think most of that is above sea level, if it is not that. But we still do not have the problems that Mississippi or the exposure in Louisiana and Florida, but there is some exposure there. And the State has to play a role here, does it not?

Mr. GALLOWAY. Yes, sir. It is a cooperative effort, and the responsibility for all of this floodplain management has got to be shared at each level, and if the State is not playing a role, it does not go very far.

Senator SHELBY. It is flawed in its design and it will not work, as Mr. Hunter has mentioned many times before this Committee.

Thank you, Mr. Chairman. I do have those questions for the record.

Senator CARPER. I suspect a number of us do. I would ask for answers, and let me just say thank you very much on behalf of all of us. Thank you for making time in your schedules to be and for really what I would describe as excellent testimony. We look forward to working with you as we go forward. Sometimes, you know, we hold hearings and not much comes of it. In this case, I think we are moving forward smartly.

Senator SHELBY. Mr. Chairman?

Senator CARPER. Yes, sir.

Senator SHELBY. One last observation. Everybody here on the panel can contribute and would contribute, but I believe if we had Dr. Galloway and Mr. Hunter, they could make this program work.

[Laughter.]

Thank you.

Mr. GALLOWAY. Sir, I have got to say I was born in Mobile, so I have an advantage.

Senator CARPER. Before we adjourn, we are going to be submitting some questions, follow-up questions in writing, and we would just ask that you reply to them fully and promptly.

Again, we thank you very much, and this hearing is adjourned.

[Whereupon, at 12:51 p.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF SENATOR MENENDEZ

Thank you, Mr. Chairman. I am glad this Committee has the chance once again to look at the issue of flood insurance. As many of us know, floods are not a static issue. Especially for those of us who come from states that have seen repeated floods, we know they can be like the wound that doesn't heal. An area struck by a flood is vulnerable to be hit over and over again. And worse, a band-aid approach just won't cut it. Like any natural disaster, floods can wash away lives in an instant. New Jersey bore witness to this earlier this year, when we experienced a devastating flood. But the Nor'easter of 2007 was only the latest of, many, catastrophic floods that have begun to plague New Jersey.

New Jersey may not come to mind as being at the top of the list for states at risk of hurricanes or floods, but the facts tell another story. New Jersey is a coastal state, with 127 miles of Atlantic coastline. More than half of New Jersey residents live in counties the National Oceanic and Atmospheric Administration list as exposed to hurricane risks. Last year alone, there were nearly 2600 claims under the National Flood Insurance Program, making New Jersey fifth in the nation for flood insurance claims.

Earlier this year, I convened a conference in New Jersey to examine the challenges our state faces and to develop a comprehensive strategy moving forwards. By no means is that challenge getting any easier. When we look at our historical flood trends, it is clear that the damage is only getting more severe. New Jersey's shoreline is at severe risk of coastal flooding. By the end of the century, sea levels are expected to rise 7 to 23 inches—if we factor in the anticipated effects of global warming, we could be talking about 2 to 4 feet. And New Jersey is certainly not alone.

With repeated floods, changes in our climate, rising home prices, and an overburdened insurance program, the task of how to effectively provide protection for homeowners at risk is a daunting one. That is why I welcome this discussion today. I look forward to hearing about potential solutions from our witnesses. There is no easy fix. But I hope that we will be able to provide a stronger, smarter, flood insurance program that guarantees homeowners they will be taken care of, and does not break the bank. It will be a difficult balance, but one I look forward to working with the Committee to make happen.

Testimony of
David I. Maurstad
Assistant Administrator and Federal Insurance Administrator
Mitigation Division
Federal Emergency Management Agency
Department of Homeland Security
Before
The United States Senate
Committee on Banking, Housing, and Urban Affairs
October 2, 2007

Good morning Chairman Carper, Ranking Member Shelby, and Members of the Committee. I am David Maurstad, Assistant Administrator for Mitigation and Federal Insurance Administrator for the Federal Emergency Management Agency (FEMA) within the Department of Homeland Security. I appreciate the opportunity to appear today before the Committee to discuss the status of the National Flood Insurance Program (NFIP).

This morning I would like to provide a context for how the NFIP has moved forward since Hurricanes Katrina, Rita and Wilma made landfall in 2005. As you know, the NFIP was established in 1968 to make affordable flood insurance available in communities that would adopt and enforce measures to make future construction safer from flooding. From 1968 through 2004, a total of $15 billion had been paid out to cover more than 1.3 million claims. From 1968 through 2004, the NFIP took in $20.5 billion in Earned Premium.

Following the June 2004 signing of the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004, the United States experienced back-to-back catastrophic hurricane seasons. The 2004 hurricane season resulted in over 75,000 claims totaling a record payment of over $2 billion. That record fell in 2005 when Hurricane Katrina resulted in claims to date totaling over $16.3 billion – over eight times that of 2004 and surpassing, by over a billion dollars, the aggregate amount of all claims previously paid in the nearly 40-year history of the NFIP.

Combined claims from 2005 Hurricanes Katrina, Rita, and Wilma total over $16.5 billion. This past June, Ed Connor, my Deputy Administrator for Insurance, testified before the House Financial Services Committee that we expected the total NFIP payout (claims and associated expenses) for the 2005 hurricane events to be approximately $20 billion. We have reexamined this calculation based on actual claims and payments to date, and we still consider this to be our best estimate.

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 NFIP, 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.

However, policyholder claims have been resolved expeditiously. By the summer of 2006, over 98 percent of our Katrina and Rita insurance claims had been closed – a volume that far exceeded the highest number of claims filed from any single event in the NFIP's history, and more than triple the total number of claims filed in 2004. Given the magnitude of these storms, our industry partners – Write-Your-Own (WYO) insurance companies, as well as claims adjusters and agents – fulfilled their responsibility effectively to help NFIP policyholders begin to rebuild their lives.

This introduction serves as a backdrop for the NFIP topics I will highlight this morning: (1) the NFIP's financial status; (2) how the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (Reform Act) has enabled the NFIP to operate more effectively; and (3) opportunities to fundamentally strengthen the NFIP's financial underpinnings.

NFIP Financial Status

The NFIP's financial status revolves around a variety of interrelated factors, issues, and events, including: (a) NFIP growth in terms of policies and assets; (b) catastrophic flooding; and (c) the NFIP's borrowing authority and its Katrina-related debt.

NFIP Status

The extremely active 2004 and 2005 hurricane seasons raised the Nation's awareness of the flood risks we all face. This activity, along with NFIP marketing efforts, has resulted in dramatic NFIP growth over the past three years. At the beginning of July 2007, the NFIP had almost 5.5 million policies for homes, businesses, and other residential and non-residential property, representing an increase of 5.8 percent from July 2006. The Program now insures in excess of $1 ***trillion*** in assets, a 13.2 percent increase over the past 12 months. The NFIP collects more than $2.5 billion annually in premiums and fees.

NFIP Solvency and Catastrophic Flooding

It is important to note that NFIP rate schemes are not designed to, in aggregate, cover catastrophic events or years, although the premiums for most properties already consider the potential for catastrophic losses. Over the years, the NFIP set premium levels to provide total program revenue covering the average, non-catastrophic loss year, plus expenses associated with administering the Program. Most of the NFIP's 2005 claims resulted from the damages caused by Hurricane Katrina, with levee failures vastly increasing the number of claims in New Orleans – circumstances not envisioned at the NFIP's inception, but from which the Program continues to learn as we work to get stronger.

Katrina-related flooding elevated our already-heightened concern about rate discounts and their affect on the Program's solvency. The NFIP provides insurance at actuarial (risk-based) rates for newer construction, with the majority of policyholders paying full actuarial rates. However, by statute, structures built prior to the mapping and implementation of NFIP floodplain management requirements are considered pre-Flood Insurance Rate Map (Pre-FIRM) buildings. Many Pre-FIRM buildings – which make up 24 percent of all NFIP policies – are charged heavily-discounted rates on the first $35,000 of the structure's insured value, and full risk-based rates for the remaining insured value. Those Pre-FIRM building owners with discounted NFIP policies are paying, on average, only 40 percent of a full risk-based premium – while the NFIP considers the remaining 60 percent as forgone revenue that is ***not*** passed on to other NFIP policyholders.

NFIP Borrowing Authority and Current Debt

From 1986 until the 2005 hurricane season, the NFIP was self-supporting. During periods of high losses, the NFIP is authorized to borrow from the U.S. Treasury. This borrowing authority is an essential part of the NFIP's financial design because it provides the Program with the resources needed in those years where claims exceed average annual historic loss levels. This authority enables the program to borrow limited amounts from the Treasury on occasions when income is not sufficient to cover claim payments and related costs. The loans from the Treasury are repaid, with interest, from policyholder premiums and related fees. Also, it is important to remember that, unlike the private insurance market, the NFIP premiums are based on expected losses in an average year as observed historically. This means premium levels set so that long run surpluses will equal zero, absent a catastrophic loss year or series of such years.

As stated earlier, I expect total payouts for the 2005 hurricanes to come close to $20 billion. Since Hurricane Katrina struck the Gulf Coast, Congress has increased the NFIP's borrowing authority three times to the present limit of $20.775 billion. To date, the NFIP has borrowed $17.535 billion to pay for Hurricane Katrina claims and for the interest payments due on that borrowing. Annual interest on Katrina-related borrowing will likely exceed $800 million by 2009 – the year we expect to approach our current borrowing limit.

Clearly, the 2005 flooding events were of a magnitude far beyond the ability of policyholder premiums to cover. The Program's additional borrowing authority has been a critical element of our ability to fulfill the promise we made to our policyholders, allowing FEMA to resolve nearly all (over 98 percent) of the Katrina, Rita, and Wilma claims received to date. However, under current loan obligation arrangements – with the NFIP needing new loans at least every six months to cover semi-annual interest payments – it is unlikely that the Program will ever be able to retire its debt.

The 2004 Reform Act and NFIP Operations

In the aftermath of Hurricane Katrina, the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (Reform Act) proved to be instrumental in our ability to effectively inform and help Gulf Coast policyholders, and it continues to be a catalyst for programmatic success and improvement. We began implementing Reform Act changes during the 2004 hurricane season, and we have since improved NFIP delivery by implementing a number of initiatives directed by this Committee in the 2004 Reform Act: (a) distributing the ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook*** to policyholders; (b) issuing informative supplemental policy coverage forms with new and renewed flood insurance policies; (c) providing acknowledgement forms to flood insurance policy purchasers; (d) implementing important agent-training initiatives, (e) adopting a flood insurance claims appeals rule, and (f) carrying out initiatives that address repetitive loss properties.

New Materials

Increasing risk awareness among homeowners and consumers with improved, succinct information is a basic NFIP principle and one of the Reform Act's most important elements. FEMA's aggressive education and outreach campaign is continuously designing and upgrading informational material to increase the public's awareness of flood risks and to keep our policyholders well-informed.

FEMA distributes the ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook*** to NFIP policyholders to help them through the claims process. These easy-to-understand materials are distributed to all policyholders when they purchase a policy, when they renew a policy, and when they file a claim. Additionally, FEMA and the Write Your Own insurance companies that participate in the NFIP distribute these materials in our Joint Field Offices, Disaster Recovery Centers, and Flood Response Centers – as well as in town Hall Meetings – as soon as possible after storms strike. Without a doubt, the ***NFIP Summary of Coverage*** and the ***Flood Insurance Claims Handbook*** have been invaluable additions to the Program and have played a major role in FEMA's ability to close claims quickly and fairly.

Supplemental Forms

The NFIP now issues supplemental forms with each flood insurance policy. These forms provide, in layman's terms, information that helps policyholders clearly understand their flood insurance coverage, such as: exact coverage purchased; exclusions from coverage; and explanations – with illustrations – of how the policy values lost items and damages. The NFIP gives these easy-to-understand forms to all flood insurance policyholders at the time of purchase and renewal, and to all insurance companies and agents authorized to sell NFIP flood insurance.

Acknowledgement Forms

The NFIP also provides flood insurance policy purchasers with an acknowledgement form. By signing this form, policyholders acknowledge receipt of the standard flood insurance policy and related supplemental material, and indicate that they understand what is and is not covered under the policy.

Training Agents That Sell Flood Insurance

Training for insurance agents that sell flood insurance continues to be a high priority for the NFIP. On September 1, 2005 FEMA published a notice entitled Flood Insurance Training and Education Requirements for Insurance Agents in the Federal Register (see 70 Fed. Reg. 52117). We have been coordinating with the States, the insurance industry, and related associations to inform our stakeholders of these requirements. To date, 42 States and the District of Columbia have made flood insurance training mandatory for agents that sell NFIP coverage. FEMA is encouraged by the continued growth of classroom and online training participation. So far, over 42,000 insurance agents have earned 3 hours of continuing education credits by completing our Basic Agent Tutorial either online or in the classroom.

Of course, FEMA would like to see all States make flood insurance training mandatory for agents. We have encouraged the States with minimum training and education criteria to place these requirements in their licensing and continuing education programs, and we will provide technical assistance and resources to all the States as appropriate.. One such resource is Agents.FloodSmart.gov. As part of our highly successful FloodSmart marketing campaign, this website provides extensive information for flood insurance agents, including links to educational and training programs.

Claims Appeals

FEMA's Flood Insurance Claims Appeals Rule became effective November 13, 2006. This Reform Act requirement formalizes a process through which flood insurance policyholders may appeal the decisions of adjusters, agents, insurance companies, and FEMA regarding claim settlements. The rule making speaks to the issue of mediation; and I emphasize that mediation is most effective when it occurs early in the claims process. I encourage companies that sell NFIP flood insurance to make, or continue to make, this alternative dispute resolution option available to policyholders. The NFIP continues to maintain its historically high success rate of resolving over 99 percent of its claims without litigation.

Currently, if a claim is denied, the insured may file an appeal directly with FEMA. The ***Flood Insurance Claims Insurance Handbook*** includes detailed instructions on how to file that appeal. This allows the policyholder to go directly to the NFIP to state their claims issues.

Addressing Repetitive Loss Properties

The 2004 Reform Act authorized a new Repetitive Flood Claims Program (RFC), which provides $10 million in annual funding to reduce or eliminate the long-term risk of flood damage to NFIP-insured structures. The Mitigation Directorate will distribute all FY07 Repetitive Flood Claim Program funds by selecting RFC property acquisition projects for 41 buildings. In

FY2006, the first year of the Program, $9.8 million was awarded for property acquisitions that purchased and removed 40 structures from floodplains.

Additionally, the Severe Repetitive Loss (SRL) Pilot Program is in its final stages of development. In fiscal years 2006 and 2007, FEMA transferred $40 million from the National Flood Insurance Fund to mitigate severe repetitive loss properties, which the Act defines as: properties that have experienced four or more flood losses of at least $5,000 each, with at least two claims payments occurring in a 10-year period, and with the total claims paid exceeding $20,000; or properties that have received at least two separate flood claims payments, where the cumulative flood claims payments exceed the value of the property. The FY 2008 President's Budget contains $80 million for the SRL program. FEMA is developing the SRL program regulations, guidance and administrative documents necessary for implementation; and once the regulations are published in the *Federal Register*, FEMA will provide guidance to potential applicants and will begin awarding funds. In July, FEMA sent letters to all State Hazard Mitigation Officers and NFIP Coordinators to inform them of how to retrieve SRL property information in their respective states, so they could identify communities with SRL properties as potential partners for this grant program.

Both RFC and SRL build on our Flood Mitigation Assistance Program (FMA). FY07 funding for this long-standing floodplain management program was $31 million, as opposed to $20 million in past years. These funds have been committed to projects and plans, and FEMA Regions are working closely with the States to obligate the money. For FY 2008, the President's budget has requested an additional $3 million to bring the program up to $34 million. All three of these mitigation programs – RFC, SRL, and FMA – play an important role in FEMA efforts to reduce repetitive loss structures and eliminate the flood-rebuild-flood cycle that residents in the Nation's flood-prone areas have become so familiar with.

Strengthening the Program

Significant flood events have played major roles in the NFIP's evolution: the Program was created after Hurricane Betsy carved a swath of destruction through the Gulf Coast in 1965; Tropical Storm Agnes provided the impetus for the 1973 Flood Disaster Protection Act, which introduced mandatory purchase requirements; and the 1993 Midwest Flood was the catalyst behind the National Flood Insurance Reform Act of 1994 and its stronger lender compliance requirements. It is entirely appropriate, therefore, that the catastrophic 2004-2005 hurricane seasons result in an examination of how the NFIP can be improved – programmatically and operationally.

<u>Programmatic Improvement</u>

Since the end of the 2005 hurricane season, in Congressional hearings and in presentations at various events nationwide, the Mitigation Directorate and the NFIP have outlined the following fundamental mitigation and insurance principles:

- The NFIP must fulfill all obligations and commitments;
- Phase out discounted premiums in order to charge policyholders fair and actuarially sound premiums;
- Increase NFIP participation 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 and all NFIP stakeholders should consider the following NFIP adjustments:

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

- Increase the penalties for Federally-regulated lending institutions that do not comply with their mandatory purchase regulatory responsibilities.

- Require a study of the feasibility and implications of expanding the standard for mandatory flood insurance purchase requirement to include 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.

However, we oppose provisions that would increase the scope of coverage offered by the flood insurance program. Increasing the coverage amounts could encourage expensive development in high-risk areas.

Operational Improvement
The September 2007 GAO report ***"FEMA's Management and Oversight of Payments for Insurance Company Services Should Be Improved"*** recommends that FEMA take steps to ensure that it has a reasonable estimate of the actual expenses WYO Companies incur and that financial audits are performed.

Since 1983, the NFIP has worked with the insurance industry to ensure that WYOs expenses are compensated fairly for the invaluable services they provide. WYO compensation has always been based on the actual operating expenses insurance companies incur while selling and servicing policies for other lines of property insurance. The NFIP has used this methodology for almost 25 years, and its results continue to be fair, timely, and consistent with other insurance industry expenses. In fact, operating expenses, as noted in the GAO report, have declined over the years. From 1996 to 2005, average underwriting expenses (as a percentage of premium income) have dropped two percent.

FEMA is working with the National Association of Insurance Commissioners to strengthen reporting requirements of industry expenses incurred in selling and servicing flood insurance policies. Additionally, FEMA is working with the industry to acquire their loss adjustment expenses – a component of their overall expense structure. FEMA also is developing additional oversight guidance for our insurance industry partners. FEMA is committed to effectively performing these important WYO biennial audits; they are extremely valuable to the NFIP, and they will be – without exception – carried out when they are supposed to be. The NFIP's Financial Management team has implemented an audit tracking and follow-up system, and the deadline to receive all 2005-2006 biennial audits was September 30, 2007.

Conclusion

The 2005 hurricane season presented the NFIP with numerous challenges on a variety of fronts, providing avenues for financial, legislative, programmatic, and operational improvements that are critical to the NFIP's continued success. Such improvements, when integrated into comprehensive mitigation strategies at the Federal, State, and community levels, will benefit policyholders, our stakeholders, NFIP communities, and the Nation. However, I want to emphasize that there is no quick solution that will enable this important Program to absorb catastrophic loss years.

I look forward to continuing to work with this Committee, our NFIP WYO companies, agent groups, and other partners to strengthen the National Flood Insurance Program and reduce the Nation's vulnerability to all natural hazard events. I will be happy to answer any questions that the Committee might have. Thank You.

United States Government Accountability Office

GAO

Testimony

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

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FEDERAL EMERGENCY MANAGEMENT AGENCY

Ongoing Challenges Facing the National Flood Insurance Program

Statement of Orice Williams, Director
Financial Markets and Community Investments

GAO

Accountability * Integrity * Reliability

GAO-08-118T

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program (NFIP) and the challenges facing the Federal Emergency Management Agency (FEMA), which oversees it. As you know, the NFIP has been on GAO's high-risk list since March 2006, and my statement today focuses on the ongoing challenges facing the program. Over the past three decades, we have identified numerous challenges to the program that affect its day-to-day operations and future financial stability. Recently, we reported on NFIP's unprecedented financial and regulatory strains in the aftermath of the 2005 hurricane season.[1] As a result, the program has had to borrow extensively from the U.S. Treasury in order to pay claims and expenses. With the current program expiring next September, this and other issues warrant review and debate, including how best to structure the NFIP so that it provides financial protection for those who need and would benefit from flood insurance while enhancing the program's financial foundation.

My testimony today will revisit and update the four major challenges facing the NFIP:

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

- Reducing losses to the program from policy subsidies and repetitive loss properties—that is, properties in high-risk areas that flood repeatedly and that make repeated claims on the NFIP;

- Increasing property owner participation in the program to include not only homeowners in high-risk areas, but also those who live in less flood-prone areas that are still at risk of experiencing losses from flooding;

- Developing accurate, digital flood maps that can provide the information the program needs to determine which areas are most at risk of flooding; and

- Providing effective oversight of flood insurance operations to ensure that the NFIP is making appropriate payments to the insurance companies, insurance agents, and claims adjusters responsible for the day-to-day process of selling and servicing flood insurance policies.

My statement is based largely on completed work on the 2005 claims process and subsequent payments to insurance companies for services rendered and ongoing work on subsidized properties; the rate-setting process for flood insurance premiums; financial and statistical information on the NFIP from a variety of sources; and the Write-Your-Own (WYO) program, under which insurance companies enter into agreements with FEMA to sell and service flood insurance policies and adjust claims after flood losses; and FEMA's oversight. In conducting our work, we collected relevant data from FEMA; analyzed statutes, regulations, and payment data relevant to the NFIP; and interviewed FEMA officials, FEMA contractors, insurance company officials, and state and local officials to obtain information relevant to their experience with NFIP. Some of the work was also based on interviews with individual policyholders, insurance agents, and claims adjusters, and on audits of private insurance companies that sell and service flood insurance on behalf of FEMA. We performed our work in accordance with generally accepted government auditing standards.

In summary:

One of the biggest challenges facing the NFIP is the actuarial soundness of the program. As of August 2007, FEMA owed over $17.5 billion to the U.S. Treasury, largely resulting from losses during the 2005 hurricanes. FEMA is unlikely to be able to pay this debt primarily because many of the program's premium rates have been set to cover losses in an average historical year based on program experience that did not include any catastrophic losses. To keep the cost of flood insurance affordable, Congress included premium subsidies, and as a result the program does not take in as much in premiums as it pays out in claims. With these subsidies, some policyholders with structures that were built before floodplain management regulations were established in their communities pay premiums that represent about 35 to 40 percent of the true risk premium. Moreover, about 1 percent of NFIP-insured properties that suffer repetitive losses account for between 25 and 30 percent of all flood claims. FEMA is also creating a new generation of "grandfathered" properties that are mapped into higher-risk areas and that have an existing policy or purchase a new flood insurance policy prior to the adoption of new maps. The properties may be eligible to receive a discounted or "grandfathered" premium rate equal to the nonsubsidized rate for their old risk designation. Placing the program on more sound financial footing will involve trade-offs in how best to balance the need for charging higher premiums, which would put the program on a sounder financial basis while continuing to encourage participation in the program.

The NFIP also faces challenges expanding its policyholder base by enforcing compliance with mandatory purchase requirements and promoting voluntary purchase by other homeowners, some of whom live in areas that are at less risk. While flood insurance is mandatory for homeowners who live in certain high-risk areas and have mortgages held by federally regulated financial institutions, determining the extent of compliance can be complicated. One recent study estimated that compliance with the mandatory purchase requirement was about 75 to 80 percent but that the penetration elsewhere in the market was only 1 percent. Moreover, since 2004, FEMA has implemented a mass media campaign called "FloodSmart" to educate the public about the risks of flooding and to encourage the purchase of flood insurance. While the numbers of policyholders has increased following Hurricane Katrina, it is unclear whether these policyholders will remain in the program as time goes on.

The impact of the 2005 hurricanes highlighted the importance of having accurate, up-to-date flood maps that identify areas that are at risk of flooding and thus the areas where property owners would benefit from purchasing flood insurance. While requirements for purchasing flood insurance apply only to certain properties in high-risk areas, according to FEMA about half of all flood damage occurs outside of areas currently mapped as high-risk areas. In response to recommendations from Congress, GAO, and others, FEMA has taken steps to adjust its map modernization efforts by changing its mapping standards and guidelines and adjusting risk-based mapping priorities. However, managing its relationship with its contractor and with state and local partners—all with varying technical capabilities and resources—to produce accurate digital flood maps is an ongoing challenge. Likewise, assuring that map standards are consistently applied across communities once the maps are created is a similar challenge.

FEMA, which oversees the NFIP program, also faces significant challenges in providing effective oversight over the insurance companies and thousands of insurance agents and claims adjusters that are primarily responsible for the day-to-day process of selling and servicing flood insurance policies. In response to our recommendations an interim report issued in September 2007, FEMA has agreed to take steps to ensure that it has a reasonable estimate of the actual expenses the insurance companies incur to help determine whether payments for services are appropriate and to ensure that required financial audits are performed.[2]

Background

The NFIP provides property insurance for flood victims, maps the boundaries of the areas at highest risk of flooding, and offers 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. These include:

- providing property flood insurance coverage for the many property owners who would benefit from such coverage;
- reducing taxpayer-funded disaster assistance for property damage when flooding strikes; and
- reducing flood damage to properties through floodplain management that is based on accurate, useful flood maps and the enforcement of relevant building standards.

[2]GAO, *National Flood Insurance Program: FEMA's Management and Oversight of Payments for Insurance Company Services Should Be Improved,* GAO-07-1078 (Washington D.C.: Sept. 5, 2007).

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. Our analysis of FEMA data found that over the past 25 years, about 97 percent of the U.S. population lived in a county that had at least one declared flood disaster, and 45 percent lived in a county that that had six or more flood disaster declarations.[3] However, flooding is generally excluded from homeowner insurance policies that typically cover damage from other losses, such as wind, fire, and theft. Because of the catastrophic nature of flooding and the difficulty of adequately predicting flood risks, as well as the fact that those who are most at risk are the most likely to buy coverage, private insurance companies have largely been unwilling to underwrite and bear the risk of flood insurance.[4]

The NFIP was established by the National Flood Insurance Act of 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.[5] In creating the NFIP, Congress found that a flood insurance program with the "large-scale participation of the Federal Government

[3]GAO, *Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework*, GAO-07-403 (Washington, D.C.: Aug. 22, 2007).

[4]According to FEMA, many private insurers offer Excess Flood Protection, which provides higher limits of coverage than the NFIP, in the event of catastrophic loss by flooding.

[5]The National Flood Insurance Act of 1968, as amended, is codified at 42 U.S.C. §§ 4001 et seq.

and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated."[6] In keeping with this purpose, 92 private insurance companies were participating in the WYO program as of September 2007. NFIP pays these insurers fees to sell and service policies and adjust and process claims. FEMA, which is within the Department of Homeland Security (DHS), is responsible for the oversight and management of the NFIP. We reported in September 2007 that about 68 FEMA employees, assisted by about 170 contract employees, manage and oversee the NFIP and the National Flood Insurance Fund, into which premiums are deposited and claims and expenses are paid. As of April 2007, the NFIP was estimated to have over 5.4 million policies in about 20,300 communities.[7] To ensure that NFIP can cover claims after catastrophic events, FEMA has statutory authority to borrow funds from the Treasury to keep the program solvent.[8]

According to FEMA, an estimated $1.2 billion in flood losses are avoided annually because communities have implemented the NFIP's floodplain management requirements. Flood maps identify the boundaries of the areas that are most at risk of flooding. Property owners whose properties are within special

[6]42 U.S.C.§ 4001(b).

[7]FEMA defines a community as, any state or area or political subdivision thereof, or any Indian tribe or authorized tribal organization, which has authority to adopt and enforce floodplain management regulations for the areas within its jurisdiction. 44 C.F.R. § 59.1 . In most cases, a community is an incorporated city, town, township, borough, or village, or an unincorporated area of a county or parish.

flood hazard areas and who have mortgages 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 for single-family homes. According to FEMA, Excess Flood Protection coverage above these amounts is available in the private insurance markets. Personal property coverage is available for contents, such as furniture and electronics, for an additional $100,000. Business owners may purchase up to $500,000 of coverage for buildings and $500,000 for contents. The owners of properties with no mortgages or properties with mortgages held by lenders who are not federally regulated are not required to buy flood insurance, even if the properties are in a special flood hazard area. Optional lower-cost coverage is available under the NFIP to protect homes in areas of low to moderate risk.

The NFIP's 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 for policies covering some properties in order to encourage communities to join the program.[9] As a result, the program does not collect sufficient premium income to build capital to cover long-term future flood losses. Moreover, the premiums

[8]See 42 U.S.C. 4016.

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

collected are often not sufficient to pay for losses even in years without catastrophic flooding. This shortfall is exacerbated by repetitive loss properties that file repeated claims with NFIP.

FEMA's current debt to the Treasury—over $17.5 billion—is almost entirely for payment of claims from the 2005 hurricanes. Legislation increased FEMA's borrowing authority from a total of $1.5 billion prior to Hurricane Katrina to $20.8 billion in March 2006. As we have testified previously, it is unlikely that FEMA will be able to repay a debt of this size and cover future claims, given that the program generates premium income of about $2 billion a year, which must first cover ongoing loss and expenses.[10]

To date, the program has gone through almost two full seasons without a major hurricane, and according to FEMA about $524 million of premium income has been used to pay interest on the debt owed to the Treasury in 2006. FEMA officials also noted that because fiscal year 2007 had been a relatively low flood loss year, the agency should be able to pay its next scheduled interest payment from premium income and would not have to borrow additional funds from Treasury to pay interest on its outstanding debt.[11] Attention has been focused on the extent of the federal government's exposure for claims payments in future

[10]GAO, *Federal Emergency Management Agency: Challenges for the National Flood Insurance Program*, GAO-07-335T (Washington, D.C.: Jan. 25, 2006).

[11]According to FEMA officials, the next scheduled payment is October 1, 2007.

catastrophic loss years and on ways to improve the program's financial solvency.[12] For example, some in Congress have recommended phasing in actuarial rates for vacation homes and nonresidential properties.[13]

Policy Subsidies Significantly Reduce NFIP's Income from Premiums

About 25 percent of NFIP's over 5.4 million policies have premiums that are substantially less than the true risk premiums. Properties constructed before their communities joined the NFIP and were issued a Flood Insurance Rate Map (or FIRM), which shows the community's flood risk, are eligible for subsidized rates. These policyholders typically 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. In response to concerns about the historical basis for the subsidies and questions about the characteristics of the homes receiving subsidies, we were asked by the Ranking Member of this committee to collect certain demographic information about the portfolio of subsidized properties and property owners. This work will provide information on

[12]See, e.g., S. 3589, § 11, 109th Cong. (2006).

[13]H.R.3121, §121,110th Cong. (2007).

residential pre-FIRM subsidized properties in selected counties of the country.[14] To the extent that reliable data is available, we plan to capture the variations that exist by type of flooding (e.g., coastal or riverine), fair market values for subsidized and nonsubsidized properties in each location, average income levels for each county, claims data for subsidized and nonsubsidized properties in each location, and the mitigation efforts being used. Our work will build upon the work of the Congressional Budget Office on values of properties in the NFIP.[15]

As part of this review, we are also examining the extent to which FEMA's nonsubsidized rates are truly actuarially based. We will assess how NFIP sets rates for its nonsubsidized and subsidized premiums, determine the total premiums the NFIP collects, and compare that amount to claims and related costs. Our analysis of FEMA's premiums and claims data should help provide insights into how FEMA sets rates.

We also have work under way that will provide a description of financial and statistical trends, by flood zone, for the past 10 years. Specifically, we have been asked to describe average premium and claim amounts by flood zone, FEMA's

[14]Our key criteria for selecting the case study counties include high number and/or percent of subsidized policies, repetitive loss properties, and number of claims paid; the type of flooding experienced by the community (e.g., coastal, riverine); geographic location (urban/rural, east and west coast, inland/coastal); population demography (racial/ethnic groups and income levels); availability of digitally enhanced-FIRM maps to enable us to overlay on Census maps; and availability of electronic county tax assessment data to enable us to match with NFIP database by property.

[15]CBO, *Value of Properties in the National Flood Insurance Program* (Washington, D.C.: June 2007).

estimates of likely losses, and the extent to which losses are attributable to repetitive loss properties or hurricanes. We will also describe the extent to which flood-damaged properties have been purchased through NFIP-funded mitigation programs. However, our ability to report on these issues will depend on the quality of FEMA's claims data. Finally, we are evaluating the adequacy of FEMA's procedures for monitoring selected contracts that support the NFIP.

Repetitive Loss Properties Continue to be a Drain on the Program

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.[16] 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.[17] Although these properties account for only about 1 percent of NFIP-covered properties, they account for between 25 and 30 percent of claims. As of September 2007 over 70,000 repetitive loss properties were insured by the NFIP.

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

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

The 2004 Flood Insurance Reform Act authorized a 5-year pilot program to encourage mitigation efforts on severe repetitive loss properties in the NFIP.[18] According to FEMA, as of September 2007 about 8,100 properties insured by the NFIP were categorized as severe repetitive loss properties. Under the pilot, FEMA is required to adjust its rules and rates to ensure that homeowners pay higher premiums if they refuse an offer to mitigate the property. The pilot program was funded in fiscal year 2006, and according to FEMA officials, FEMA has not yet developed the regulations, guidance, and administrative documents necessary for implementation.

Remapping Is Creating A New Generation of Properties That May Not Pay Risk-based Premiums

FEMA is also creating a new generation of properties that may not pay risk-based premiums. Properties that are remapped into higher flood risk areas may be able to keep or "grandfather" the nonsubsidized rates associated with their risk level prior to being remapped into a higher flood risk area. As a result, eligible property owners who have an existing policy or who purchase new flood insurance policies before they are mapped into higher-risk areas will go on

[18] A severe repetitive loss property is defined as a single family property or a multifamily property that is covered under flood insurance by the NFIP and has incurred flood-related damage for which 4 or more separate claims payments have been paid under flood insurance coverage, with the amount of each claim payment exceeding $5,000 and with cumulative amount of such claims payments exceeding $20,000; or for which at least 2 separate claims payments have been made with the cumulative amount of such claims exceeding the reported value of the property. 42 U.S.C. § 4102a(b)

paying the same nonsubsidized premium rate.[19] Moreover, these grandfathered rates can be permanent. Although this option is a major selling point of encouraging broader participation in the program, such actions may further erode the actuarial soundness and financial stability of the program.

FEMA Has Expanded Participation in the NFIP, but Ensuring Compliance with Requirements Need Ongoing Attention

From 1968 until the adoption of the Flood Disaster Protection Act of 1973, buying flood insurance was voluntary. However, voluntary participation in the NFIP was low, and many flood victims did not have insurance to repair damages from floods in the early 1970s. In 1973 and again in 1994, Congress enacted laws requiring that some property owners in special flood hazard areas buy NFIP insurance. The owners of properties with no mortgages or properties with mortgages held by lenders that were not federally regulated were not, and still are not, required to buy flood insurance, even if the properties are in special flood hazard areas.

As we have reported in the past, viewpoints differ about whether lenders were complying with the flood insurance purchase requirements, primarily because the officials we spoke with did not use the same types of data to reach their

[19] Generally, post-Flood Insurance Rate Map (Post-FIRM) buildings built in compliance with the floodplain management regulations will continue to have favorable rate treatment even though higher base flood elevations or more restrictive, greater risk zone designations result from Flood Insurance Rate Map revisions. Property owners can also purchase policies after they are remapped by proving that the property was previously mapped.

conclusions.[20] For example, federal bank regulators and lenders based their belief that lenders were generally complying with the NFIP's purchase requirements on regulators' examinations and reviews that were conducted to monitor and verify lender compliance. In contrast, FEMA officials believed that many lenders frequently were not complying with the requirements, an opinion that they based largely on estimates computed from data on mortgages, flood zones, and insurance policies; limited studies on compliance; and anecdotal evidence indicating that insurance was not always purchased when it was required. At the time of our report in 2002, neither side was able to substantiate these claims with statistically sound data. However, a FEMA-commissioned study of compliance with the mandatory purchase requirement estimated that compliance with purchase requirements, under plausible assumptions, was 75 to 80 percent in special flood hazard areas for single-family homes that had a high probability of having a mortgage.[21] The analysis conducted did not provide evidence that

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

[21]RAND Corporation, *The National Flood Insurance Program's Market Penetration Rate: Estimates and Policy Implications*, 2006. This range is based on calculations, using estimates from a stratified random sample of data from 2004. Given the nature of the sample the estimates cannot be extrapolated to communities excluded from NFIP, New York City, and communities in Puerto Rico, Virgin Islands, Guam, and American Samoa. Assumptions made in calculating compliance rate were: (1) The number of policies underwritten by private insurers is 7 percent of the number in Special Flood Hazard Areas (SFHA) by NFIP; (2) 85 percent of mortgages in SFHAs are subject to the mandatory purchase requirement; and (3) The market penetration rates for homes that have mortgages but are not subject to the mandatory purchase requirement is 38 percent (the market penetration rate for homes where the probability of a mortgage is low or uncertain). As with any statistical sample there is error associated with the estimates. Certain regions included estimates with considerable uncertainty, and a larger sample size would be needed to make more definitive conclusions.

compliance declined as mortgages aged. At the same time, the study showed that about half of single-family homes in special flood hazard areas had flood insurance.

The 2006 study also found that while one-third of NFIP policies were written outside of special flood hazard areas, the market penetration rate was only about 1 percent. Yet according to FEMA about half of all flood damage occurs outside of high risk areas. FEMA has efforts under way to increase participation by improving the quality of information that is available on the NFIP and on flood risks and by marketing to retain policyholders currently in the program. In October 2003, FEMA contracted for a new integrated mass marketing campaign called "FloodSmart" to educate the public about the risks of flooding and to encourage the purchase of flood insurance. Marketing elements being used include direct mail, national television commercials, print advertising, and Web sites that are designed for communities, consumers, and insurance agents. According to FEMA officials, in the little more than 3 years since the contract began, net policy growth has been almost 24 percent, and policy retention has improved from 88 percent to almost 92 percent. However, the success of the program will be measured by retention rates as policyholders' memories of the devastation from Hurricane Katrina begin to fade over time.

FEMA Faces Challenges in Producing Accurate, Updated Flood Maps

Accurate flood maps that identify the areas that are at greatest risk of flooding are the foundation of the NFIP. These maps, which show the extent of flood risk across the country, allow the program to determine high-risk areas for designation both as special hazard zones and as areas that can benefit the most from mitigation. Flood maps must be periodically updated to assess and capture changes in the boundaries of floodplains resulting from community growth, development, erosion, and other factors that affect the boundaries of areas at risk of flooding. The maps are principally used by (1) the communities participating in the NFIP, to adopt and enforce the program's minimum building standards for new construction within the maps' identified floodplains; (2) FEMA, to develop 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. As we reported in 2004, FEMA has embarked on a multiyear effort to update the nation's flood maps at a cost in excess of $1 billion.[22] At that time we noted that NFIP faced major challenges in working with its contractor and state and local partners to produce accurate digital flood maps.

FEMA has taken steps to improve these working relationships by developing a number of guidelines and procedures. According to FEMA, the agency has

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

developed a plan for prioritizing and delivering modernized maps nationwide, including developing risk-based mapping priorities. Moreover, FEMA has recognized that a maintenance program will be needed to keep the maps current and relevant. For example, several strategies are under consideration for maintaining map integrity, including reviewing the flood map inventory every 5 years, as required by law; updating data and maps more regularly, as needed; addressing any unmet flood mapping needs and assessing the quality and quantity of maps; and examining risk management more broadly.[23] However, the effectiveness of these strategies will depend on available funding and FEMA's ongoing commitment to ensuring the integrity of the maps. As of September 2007 FEMA had remapped 34 percent of its maps.[24]

FEMA's Monitoring and Oversight Have Identified Specific Problems but Have Not Produced Comprehensive Information on Overall Program Performance

To meet its monitoring and oversight responsibilities, FEMA is required to conduct periodic operational reviews of the private insurance companies that participate in the WYO program. In addition, FEMA's program contractor is required 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 must thoroughly examine the companies' NFIP underwriting and claims settlement processes and internal controls,

[23]National Flood Insurance Reform Act of 1994, § 575. 42 U.S.C. §4101.

[24]According to FEMA, the almost 34 percent includes both new preliminary and effective maps.

including checking a sample of claims and underwriting files to determine, for example, whether a violation of procedures has occurred, an incorrect payment has been made, or a file does not 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, among other things, expenses that were paid that were not covered and covered expenses that were not paid. In our December 2006 report, we found that a new claims handling process aided the claims handling following the 2005 hurricane season and resulted in few complaints. As a result, 95 percent of claims were closed by May 2006, a time frame that compared favorably with those of other, smaller recent floods.[25] However, we noted that FEMA had not implemented a recommendation from a prior report that it do quality reinspections based on a random sample of all claims.[26] We also found that FEMA had not analyzed the overall results of the quality reinspections following the 2005 hurricane season. In response, FEMA has agreed to (1) analyze the overall results of the reinspection reports on the accuracy of claims adjustments for future events, and (2) plan its reinspections based on a random sample of claims.

[25]GAO-07-169.

[26]GAO, *Federal Management 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).

FEMA faces challenges in providing effective oversight of the insurance companies and thousands of insurance agents and claims adjusters that are primarily responsible for the day-to-day process of selling and servicing flood insurance policies. For example, as we reported in September 2007, 94 WYO insurance companies had written 96 percent of the flood insurance policies for the NFIP as of December 2006, up from the 48 companies that were writing 50 percent of the policies in 1986.[27] We also reported that for fiscal years 2004 through 2006, total operating costs that FEMA paid to the WYO insurance companies ranged from $619 million to $1.6 billion, or from more than a third to almost two-thirds of the total premiums paid by policyholders to the NFIP, as a result of unprecedented flood losses caused by the 2005 hurricanes. FEMA regulations require each participating company to arrange and pay for audits by independent certified public accounting firms. However, many WYO insurance companies have not complied with the schedule in recent years. For example, for fiscal years 2005 and 2006, 5 of 94 participating companies had biennial financial statement audits performed. In response to our recommendations, FEMA has agreed to take steps to ensure that it has reasonable estimates of the actual expenses that WYO insurance companies incurred to help determine whether payments for services are appropriate and that required financial audits are performed.

[27]GAO-07-1078.

Building on this body of work, we are beginning a follow-up engagement that will analyze the expenses WYO insurance companies incur from selling and servicing NFIP policies and determine whether the total operating costs paid to the companies are equitable relative to those costs. We will also examine how FEMA oversees the WYO program, including reinspecting claims and performing operational reviews. Finally, we will evaluate alternatives for selling and servicing flood insurance policies and processing claims.

We are also completing an engagement that looks at the inherent conflict of interest that exists when a WYO insurance company sells both property-casualty and flood policies to a single homeowner who is subject to a multiple peril event such as a hurricane. We testified before the House Committees on Financial Services and Homeland Security in June 2007 about our preliminary views on the sufficiency of data available to and collected by FEMA to ensure the accuracy of claims payments.[28] FEMA has determined that it does not have the authority to collect wind damage claims data from WYO insurance companies, even when the insurer services both the wind and flood policies on the same property. Hence, FEMA generally does not know the extent to which wind may have contributed to total property damages. However, FEMA officials do not believe that the agency needs to know the dollar amount of wind damages paid by a

[28]GAO, *National Flood Insurance Program: Preliminary Views on FEMA's Ability to Ensure Accurate Payments on Hurricane-Damaged Properties,* GAO-07-991T (Washington, D.C.: June 2007).

WYO insurance company to verify the accuracy of a flood claim. While they may not need this information for many flood claims, the inherent conflict of interest that exists when a single WYO insurance company is responsible for adjusting both the wind and flood claim on a single property calls for the institution of strong internal controls to ensure the accuracy of FEMA's claims payments. Without internal controls that include access to the entire claim file for certain properties (both wind and flood), FEMA's ability to confirm the accuracy of certain flood claims may be limited. While the DHS Inspector General is currently examining this issue by reviewing both wind and flood claims on selected properties. Its interim report, issued in July 2007, was generally inconclusive.[29]

Concluding Observations

As our prior work reveals, FEMA faces a number of ongoing challenges in managing the NFIP that, if not addressed, will continue to threaten the program's financial solvency even if the program's current debt is forgiven. As we noted when we placed the NFIP on the high-risk list in 2006, comprehensive reform will likely be needed to stabilize the long-term finances of this program. Our ongoing work is designed to provide FEMA and Congress with useful information to help assess ways to improve the sufficiency of NFIP's financial resources and its current funding mechanism, mitigate expenses from repetitive

[29]Department of Homeland Security, Office of Inspector General, *Interim Report: Hurricane Katrina: A Review of Wind Versus Flood Issues,* OIG-07-62. (Washington, D.C.: July 2007).

loss properties, increase compliance with mandatory purchase requirements, and expedite FEMA's flood map modernization efforts.

As you well know, placing the program on more sound financial footing involves a set of highly complex, interrelated issues that are likely to involve many trade-offs. For example, increasing premiums to better reflect risk would put the program on a sounder financial footing but could also 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). As a result, taxpayer exposure for disaster assistance resulting from flooding could increase. As we have said before, meeting the NFIP's current challenges 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

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TESTIMONY

Association of State Floodplain Managers, Inc.

before the
Senate Committee on Banking, Housing and Urban Affairs

Improvements to the National Flood Insurance Program 2007

October 2, 2007

presented by
Chad Berginnis, CFM, former ASFPM Chair
State Hazard Mitigation Officer, State of Ohio

The Association of State Floodplain Managers is pleased to respond to the Committee's request for our views on improvements needed for the National Flood Insurance Program (NFIP). This oldest of FEMA's hazard mitigation programs continues to evolve in response to community and policy holder needs while adhering to its original goals.

WHO WE ARE

The Association of State Floodplain Managers, Inc. (ASFPM) and its 26 Chapters represent over 11,000 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 worked with communities impacted by hurricanes Katrina and Rita or work with organizations that continue to support the 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 state members are designated by their governors to coordinate the National Flood Insurance Program 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.

EVOLUTION OF THE NFIP: AN INSURANCE AND MITIGATION PROGRAM

When discussing reforms and improvements to the NFIP, it is important to keep in mind that this is not ONLY an insurance program. It cannot be evaluated and improved in ways that might be used in the private insurance because the NFIP includes hazard identification and risk reduction components, with significant benefits that accrue to the public, including public safety and property loss reduction benefits. The NFIP saves the federal government (and state and local governments) substantial amounts in losses avoided (through application of the land use management required at the local level) and in reduced disaster assistance. We urge the Committee to view all recommendations not solely in the context of an insurance program, but in the NFIP's proper context of three-component program that involves insurance, hazard identification, and risk management. The insurance elements of the program should foster and encourage mitigation, which is a significant part of how the nation will reduce human suffering and flood losses.

Prior to the 1960s, engineered works constituted the government's primary tools to reduce flood losses. Public policy emphasized that flood losses could be curbed by controlling floodwater with structures, such as dams, levees and floodwalls. By the 1950s people and policymakers began to question the effectiveness of the focus on this single solution. Disaster relief expenses were going up, making all taxpayers pay more to provide relief to those with property in floodplains. Floods were then, and continue to be, the Nation's most frequent and costly natural hazard that affects every state and over 20,000 flood-prone communities. Studies during the 1960s concluded that flood losses were increasing, in spite of the number of flood control structures that had been built. Unfortunately, this trend is still evidenced today, although progress is being made with multi-pronged mitigation approaches. At the time, insurance against flood damage was not available because the private insurance industry deemed it not profitable since the hazard was concentrated along rivers and shorelines and because only those who had flooded would buy it.

One of the main reasons structural flood control projects failed to reduce flood losses was that people continued to build in floodplains. In response, federal, state and local agencies began to develop policies and programs with a "non-structural" emphasis, ones that did not prescribe projects to control or redirect the path of floods. Since the 1960s, floodplain management has evolved from heavy reliance on flood control, or structural measures, to one using a combination of many tools. The creation of the National Flood Insurance Program in 1968 was a landmark step in this evolution. Some of the objectives that Congress addressed by creating the NFIP include:

- Establishment of an insurance program as an alternative to disaster relief paid out of the Treasury, and thus burdening all federal taxpayers
- Providing those at risk of flooding with better financial protection than can be offered only through disaster assistance (higher dollar amounts and insurance is effective whenever a qualifying event occurs, not only when the President declares a disaster)
- Assurance that those living in "at risk" flood-prone locations would contribute toward their recovery from damage, a cost of living at risk
- Distribution of responsibility for managing flood hazard areas among all levels of government, with particular emphasis on local land use controls
- Establishment of a national standard for regulating new development in floodplains
- Development of a comprehensive flood hazard mapping program to identify areas that are at risk of flooding where land use controls apply and where insurance is appropriate financial protection for floodplain occupants

Today, the NFIP is a well-founded, three component program:

- **Flood hazard maps** that are used to identify the flood hazard from the 1% annual chance flood (misleadingly referred to as the 100-year flood) in an area and published as a Flood Insurance Rate Map. FIRMs may also identify other detailed flood hazards such as a 10-year or 500-year flood, or may simply show an "approximate" flood zone where it is suspected flooding would occur during a 100-year event. Flood mapping methods and technologies have changed significantly over the past 20 years – no longer are maps "hand drawn;" rather, technology has allowed for much better flood mapping to be produced.
- **Flood insurance** that is underwritten by the NFIP whereby rates are set utilizing the flood hazard maps. Flood insurance rate setting accounts for the presence of the extensive building stock that pre-dated the creation of the NFIP by allowing for those structures to have a subsidized (or, more precisely, cross-subsidized within the NFIP) rate, while structures built after the date the flood maps are effective are rated actuarially, or based on their actual risk. Flood insurance is largely dependent on the network of private insurance companies (also called Write Your Own or

WYO) to understand the flood insurance program, to market flood insurance, to write accurate flood insurance policies, and to communicate the benefits to policy holders.

- **Floodplain management / mitigation** that allows for communities throughout the nation to "join" the NFIP by adopting and enforcing local land use regulations that apply to all development and redevelopment in the mapped flood hazard areas. Joining the NFIP is what makes flood insurance available throughout the community. The reason that buildings constructed after the date of effective maps are actuarially rated is that new structures built to those standards are more resilient to the 100-year flood event than if there were no regulations in place. Also, the local floodplain manager is key, in a post-disaster environment, to unlocking the benefits of the mitigation aspect of the flood insurance policy – Increased Cost of Compliance coverage.

The three components of the NFIP work together to provide an insurance alternative to disaster assistance, both in an attempt to reduce the taxpayer cost of disasters and to allow for property owners to more fully recover from flood events, and to distribute the responsibilities to all levels of government and the private sector.

The NFIP is one tool in a toolbox that is used in the United States to manage flood risk. Non-structural hazard mitigation programs, hazard mitigation planning, structural flood control systems, stream gaging, flood warning, weather forecasting, and watershed management all bring resources to bear on the flood problems that are experienced in the United States. Interestingly, these efforts are often integrated and dependent on one another. For example, stream gaging provides the data that is necessary for many uses, including: flood warning systems; modeling for flood mapping that is part of the NFIP; design input for structural flood control systems; and data for benefit-cost analysis used in hazard mitigation programs.

EVALUATIONS OF THE NFIP

Detailed evaluations and analyses are important so that policy makers can make informed decisions as to the future direction of any government program. For the NFIP, several recent such evaluations, both large and small, have occurred.

American Institutes of Research

ASFPM had long urged a comprehensive evaluation of the NFIP and we are pleased that FEMA undertook such an effort which has resulted in the recent release of 14 reports (online at http://www.fema.gov/business/nfip/nfipeval.shtm). More than 100 recommendations were made by the independent researchers. FEMA has indicated that it has evaluated the recommendations and is determining priorities and plans of action. ASFPM applauds FEMA's willingness to have so many aspects of the program examined in this manner and we look forward to FEMA's efforts to implement and improve the NFIP. We suggest that the Committee request a briefing from FEMA on its plan of action, and monitor progress in the coming years.

ASFPM
We will be reviewing the NFIP evaluation reports and proposed plans of action in light of ASFPM's recently completed "National Flood Programs and Policies in Review, 2007" (online at http://www.floods.org). This document contains our long-term policy positions on all aspects of national flood policy and floodplain management, including the NFIP.

OVERVIEW OF NFIP REFORMS

The nation has been served well by the NFIP. It is vital that reforms of the NFIP consider strengthening all three components of the program based on experience from flood catastrophes such as Katrina, as well as ongoing program evaluations. Despite the NFIP's significant insurance loss experience after Hurricane Katrina, it is evident that the program does work as intended. Consider the following:

- Immediately after Katrina, FEMA embarked on a large scale effort to provide recovery mapping to affected areas, updating some maps that were over 20 years old. What effect will use of these maps have on the recovery and reconstruction effort? ASFPM believes that it will be positive and lead to more disaster resilient communities.
- Every year the land use and building requirements that are part of the NFIP result in over $1 billion in avoided losses.
- A significant number of the nation's buildings that pre-date the NFIP and that have received multiple NFIP claim payments were in the Katrina affected area. What will the future cost savings be when those structures are rebuilt to the NFIP's standards which require elevating to the 100-year flood elevation vs. remaining at a much higher risk level? ASFPM believes it could be significant, especially if substantially damaged pre-FIRM repetitive loss structures are rebuilt to current codes and standards.

In the near term future, the insurance component needs to be altered to improve the financial stability of the NFIP. These efforts must be carefully crafted to avoid the unintended consequence of pricing the policy far above that which policy holders will pay which could lead to a reduction in the number of flood policies (and thus fewer people with the financial protection against future floods). Flood map modernization must be recognized as an ongoing investment. And, while updating the maps, we need to examine and identify flood-related hazards so that people have risk information available when making decisions to build – and rebuild – in the nation's flood hazard areas. . Finally, the floodplain management standards of the NFIP need to be reviewed and revised to incorporate what flood risk managers know are sensible changes to better protect structures against flooding and to recognize the function of the natural floodplain.

The U.S. House of Representatives recently approved a bill that would add wind coverage to the NFIP. ASFPM has grave concerns about that concept and can no longer support H.R. 3121. We have provided details of our concerns in an appendix to this testimony.

THOUGHTS ON IMPROVING THE NATION'S FLOOD MAPS

One of the NFIP's most significant responsibilities that benefits the public is the creation and publication of the Flood Insurance Rate Maps (FIRM). Since the NFIP's inception, the FIRM has become the primary source of flood hazard information used by individuals to make management decisions, by communities to administer floodplain management requirements, by emergency managers to develop evacuation scenarios, by environmental programs to protect coastal and riparian habitats and wetlands, and by lenders to comply with mandatory purchase requirements of the law. The daunting task of developing the nation's initial flood data layer (floodplain information that was developed and published on individual paper flood maps) was the primary focus of the early mapping efforts of the 1970s and 1980s.

From the late 1980s through the 1990s, flood mapping made little progress largely because funds were limited to a portion of the income generated by the policy service fee assessed on NFIP flood insurance policies. The approximately $50 million a year available for maps from this source was largely consumed by processing Letters of Map Change for individual properties made necessary because the flood maps had become outdated. In the early 2000s, a growing awareness of the inability of the FEMA to keep paper flood maps accurate in light of ongoing development, land use changes, and other factors, led to the five-year initiative now known as Map Modernization. The goal was to improve the flood maps by updating and improving the flood data layer and by converting data to a common, electronic GIS-based platform. A standard task when updating maps is to identify available flood hazard information and, where necessary, to conduct new studies which include hydrology, hydraulics, and engineering.

In recent years it has become clear that, for a number of reasons, the initial expectations for map modernization accomplishments cannot be fully achieved in a five year period. The number and scope of map needs that were identified by states and communities in order to reduce exposure of new development and to mitigate existing exposure proved to be greater than originally estimated. A mid-course adjustment was made to assure map quality since a "population-mapped" metric was found to be leading towards digitizing existing data, rather than towards more time-consuming but necessary engineering flood studies. Hurricanes Katrina, Rita and Wilma necessitated a major unanticipated and unprecedented effort and diversion of funds from the nationwide effort to develop advisory maps for the affected areas of the Gulf Coast.

Funding for map modernization is limited and priorities must be made. ASFPM believes that the funds appropriated for map modernization and any subsequent, ongoing mapping funds, should be focused on updating the flood hazard data layer. Where existing flood data are not adequate, new flood studies are necessary. The most critical needs are to address outdated flood models, to identify all of the floodplains, and to convert maps to a GIS platform. ASFPM notes – but disagrees with – recommendations by some to acquire new nationwide ground elevation data as part of FEMA's mapping program.

State and local governments are increasingly purchasing topographic data to meet many needs. Just two examples among many, the State of North Carolina has made such an investment, and the State of Ohio is developing statewide data. ASFPM recommends that if a large scale investment in ground elevation data is deemed appropriate by others, the effort should:

- be led at the federal level by the U. S. Geological Survey, which is the agency traditionally charged with such a mission;
- leverage state and local mapping investments that have already been made; there should not be a system of licensure and every effort must be made to ensure that the data are open source, so that they can be made widely and freely available;
- require contribution by the various agencies that would benefit from the updated maps, such as the Departments of Interior, Agriculture, Transportation, Commerce, Homeland Security, and others.

THOUGHTS ON IMPROVING FLOOD INSURANCE

We wish to emphasize that FEMA reports that the program has been self-supporting for 20 years, since 1986. Prior to Hurricane Katrina, income from policyholders covered claims and all operating expenses, including salaries and expenses of the Federal employees who administer the NFIP and floodplain management programs. From time to time the NFIP exercised its authority to borrow from the U.S. Treasury when claims exceeded short-term income. Importantly, the program was praised for its ability to repay debts ahead of schedule and with interest. This is exactly the way the program was intended to function.

While the original framers of the NFIP discussed the impact of catastrophic losses, it was determined that the program could not concurrently meet a goal of "affordability" while also addressing catastrophic losses. We urge that the Committee keep in mind that the NFIP has multiple goals, and providing flood insurance that is reasonably priced in order to avoid direct government subsidy of flood damage is an important goal. A number of studies have concluded that if premiums rise too steeply or become too costly, many policyholders will find ways to avoid buying flood insurance. The consequence of having fewer people insured against known risks would be greater reliance on tax-payer funded disaster assistance and an increase in casualty loss tax deductions.

Whether the NFIP is effective in providing flood insurance to those at highest risk must be analyzed from the standpoint of two different types of risk: (1) those properties at highest physical risk – such as those that are in deep floodplains, and velocity riverine and/or coastal flood zones; and (2) those whose occupants are at highest financial risk should a flood loss occur – primarily those who are at lower or moderate incomes. In the case of the first, there must be a recognition that there are areas where the flood risk is very high, which is why a V-zone policy rate is usually higher than an A-zone rate. In the case of the second, a selective reduction of the pre-FIRM subsidy and preserving it for owner-occupied residences (which in many flood-prone areas tend to be low to moderate income households), is a sensible approach. Perhaps a better approach is using the NFIP-funded mitigation grant programs (see below) and FEMA's other mitigation grant programs to, in the long term, address those at highest risk from flooding through such projects as floodplain buyout, elevation-in-place, relocation, demolition and rebuilding, drainage improvements, and other measures.

Ensuring that people with properties in flood-prone areas buy flood insurance is a vexing problem that the NFIP and floodplain managers have faced for years. After nearly 40 years of the NFIP, the number of flood insurance policies is still unacceptably low. It is estimated that about 50% of structures in Special Flood Hazard Areas nationwide are covered by flood insurance. Yet the basic premise of using an insurance pooling mechanism to shift the risk of flood damage from all taxpayers to those who have chosen to live at risk remains good public policy. The 1994 National Flood Insurance Reform Act included provisions for greater lender compliance (including stiffer penalties) with the mandatory purchase requirement. The NFIP's statistics show the consequent growth in policies, both in mapped flood hazard areas and on buildings outside of those areas. Part of the low percent of property owners with flood insurance is due to the number of mortgages that are not subject to the mandatory purchase requirements; part is because many owners drop their policies when they pay off their mortgages.

THOUGHTS ON IMPROVING THE NFIP'S FLOOD MITIGATION

ASFPM has long appreciated Congress's recognition that the NFIP can be strengthened by helping communities undertake mitigation projects to work with owners of older, at-risk buildings reduce their exposure through mitigation. Flood mitigation projects include such measures as floodplain buyout, elevation-in-place, relocation, demolition and rebuilding, drainage improvements, and other measures. The benefits accrue to all policy holders because, as FEMA reports, 2% of insured properties receive about 30% of claims. The pressure to raise the rates on everyone will be reduced through mitigation. Hundreds of communities and thousands of flood-prone homes have benefited.

The NFIP currently contains two mechanisms to help mitigate pre-FIRM buildings, with particular focus on those that are characterized as "repetitive loss" properties because they have received multiple flood insurance claim payments. The Flood Mitigation Assistance Program, authorized in 1994 and modified in 2004, now makes available $40 million a year from the National Flood Insurance Fund. The Severe Repetitive Loss Pilot Program, authorized in 2004, is intended to make available $40 million a year for 5 years, but FEMA has not yet issued regulations and guidance. The Repetitive Flood Claims program, also authorized in 2004, was intended to provide $10 million a year from the Fund to allow FEMA to focus on projects that are in the best interests of the NFIP but are located in communities that do not meet the requirements for other programs. ASFPM suggests that these programs require some adjustments to be more effective:

- For the Severe Repetitive Loss Pilot, ASFPM members have growing concerns that the program as specific in statute may be so constrained as to make implementation impossible.
- For the Repetitive Flood Claims program, ASFPM believe that the guidance and regulations implementing program do not clearly reflect Congressional intent.

The Increased Cost of Compliance (ICC) coverage was authorized in 1994. It is triggered when the degree of damage is such that the local floodplain management ordinance requires the building to be brought into compliance (e.g., by raising the building on a higher foundation). At present, ICC offers up to $30,000 although FEMA reports that average claim payments are considerably less. When a property that is eligible for ICC is part of a community's buyout project, the ICC payment can be used as part of the non-federal cost share to cover a few of the costs of such projects. ASFPM suggests that ICC requires some adjustments to be more effective.

NFIP REFORMS ASFPM COMMENDS FOR CONSIDERATION

A. REFORM THE PREMIUM RATE STRUCTURE

ASFPM supports gradual movement to actuarial rates for pre-FIRM non-residential buildings and non-primary residences (and for owners that decline a mitigation offer under the Severe Repetitive Loss grant program authorized in 2004). ASFPM supported the provision of the Flood Insurance Reform Act of 2004 which requires that actuarial rates be phased-in for severe repetitive loss properties that have declined an offer of mitigation assistance (although authorized in 2004, this grant program is not expected to be operational until later this year or next year). We believe it is appropriate to see several years of experience with states and communities focusing mitigation grant funds on severe repetitive loss properties before such properties are moved to actuarial rates.

At this time, ASFPM does not support charging actuarial rates on other categories of properties, specifically we do not support it for new and lapsed policies, and for properties that have received multiple claim payments. We believe that the cumulative impacts of the above (and other suggested proposed changes) should be examined before additional categories of subsidized buildings are addressed. We are particularly concerned with charging actuarial for new and lapsed policies, in part because it may have a particularly adverse impact on low and moderate income families. A number of studies have reported on the impact of charging actuarial rates on all policies; the potential adverse economic impact should be better understood before such a change is made.

B. EXPAND MANDATORY PURCHASE OF FLOOD INSURANCE TO "RESIDUAL RISK" AREAS

Nearly every year, somewhere in this country flooding occurs that exceeds the 1%-annual chance level (100-year) or results from failure or overtopping of a flood control structure. ASFPM is very supportive of expanding the requirement that lenders require borrowers to purchase flood insurance in "residual risk" areas. The importance of flood insurance for these areas was evident in after Hurricane Katrina and other locations where dams and levees have failed. It is readily apparent in areas like Sacramento, where the State of California and its citizens are engaged in heavy discussion on this important issue. They recognize that if property owners are not insured for flood damage, the consequences of levee failure would have a devastating impact on the State's economy

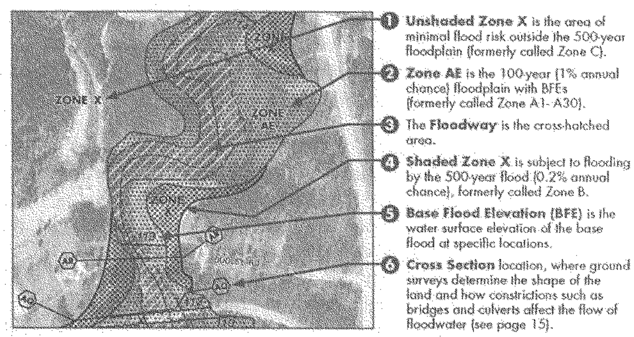
Care must be taken in defining such areas and they must not be confused or combined with "special flood hazard areas." The term "special flood hazard areas" (and the term "areas of special flood hazard") is a technical term used specifically to refer to the floodplain associated with the Base Flood, which is the 1%-annual-chance flood. The term is used throughout the statute and the NFIP regulations, in both the land management and the insurance requirements.

ASFPM recommends that the residual risk areas in which flood insurance would be required are those where the probability is known to be lower than the 1%-annual chance, including the 0.2%-annual chance flood hazard area (500-year floodplain), and what is now called the "natural 100-year floodplain" to denote areas that would be subject to flooding except for the presence of a flood control structure. In terms of the effort required, it is important to note that delineating the 0.2%-annual chance floodplain is not an entirely separate operation from delineating the 1%-annual chance floodplain; it will not significantly increase the cost of mapping if both are done at the same time.

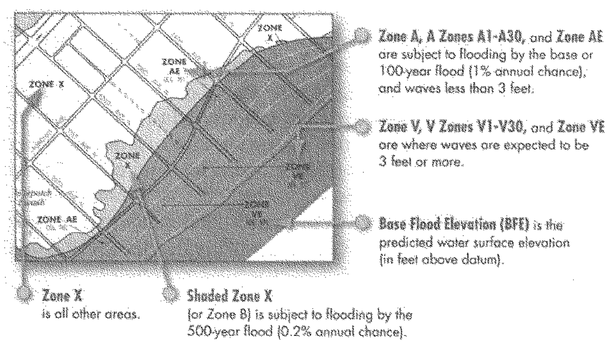
Many current Flood Insurance Rate Maps include the 500-year floodplain (see "shaded X Zone" in examples below), and many more maps are being revised as part of FEMA's multi-year Map Modernization initiative. ASFPM urges that the requirement to purchase flood insurance in these residual risk areas be instituted immediately so that those property owners have greater financial protection. Lenders charge borrowers a fee to check every mortgage application to determine whether improvements securing loans are located in the special flood hazard areas (A and V Zones). Therefore, requiring insurance in mapped residual risk areas will not increase lender or borrower costs.

Recommendations:

- Direct the Director to define "residual risk areas" to include areas that are subject to flooding by the 0.2%-annual chance flood, areas subject to coastal storm surge flooding, and areas that would be subject to flooding but for the presence of flood control structures such as levees, dams, and other man-made structures.
- Require lenders to require insurance in mapped residual risk areas.
- Require FEMA to report to Congress on the rate structure for residual risk areas and how it compares to the current rate structure for policies written outside of special flood hazard areas (100-year floodplain).



Digital FIRM (riverine)



Paper FIRM (coastal)

C. INCREASE MINIMUM DEDUCTIBLES FOR CERTAIN PROPERTIES

Increasing the minimum deductibles for claims made on pre-FIRM buildings has merit in that it will reduce the number and total payments for small losses (which are a considerable part of the repetitive loss problem). However, doing so could have a disproportionate negative impact on low and moderate income people who do not own high-value homes or the disposable income necessary to provide the deductible. One option to limit this adverse effect might be to increase the minimum deductible for policies above a certain amount of coverage (e.g., median coverage amount).

D. EXPAND AND STRENGTHEN MANDATORY PURCHASE

ASFPM concurs with the proposals in last year's S. 3589 to extend mandatory purchase requirements to non-Federally regulated lending entities and to include the allowance to escrow flood insurance premiums. Although lender compliance has improved, increased penalties on lenders for non-compliance deserve consideration.

E. FORGIVE THE NFIP'S CURRENT DEBT

Between the late 1980s and Hurricane Katrina, the NFIP was self-supporting (income covered claims and expenses, including federal salaries). During those years, the program operated as envisioned by the original framers – when claims exceeded income, the NFIP borrowed from the Treasury, paying back with interest. Only a few times in the program's history has Congress forgiven debt, estimated to be approximately $2 billion. While we acknowledge the burden of the NFIP's debt, we believe the program should be credited with the savings of over $1 billion per year that the NFIP's actuaries have reported. Those savings largely are associated with state and local administration of the land use and control measures that they use to determine how development is undertaken in mapped flood hazard areas.

F. PROCEED CAUTIOUSLY REGARDING A RESERVE FUND

ASFPM recognizes that, even with long-term investment in mitigation to reduce repetitive claims, the NFIP will be faced with financial challenges in coming years. However, we are concerned the a very large premium increase would be required to build a reserve fund in just ten years of the size anticipated in last year's bill. Based on current total exposure*, the reserve fund that was proposed in last year's bill would need to collect approximately $1 billion a year for 10 years. This suggests that (in the absence of a mandated annual cap on rate increases) a rate increase on the order of 40% would be required (or $190 increase on the average premium of $480). Absent rate increases, building a reserve by $1 billion per year would consume more than one-third of the annual premium income (currently on the order of $2.4 billion). This would make it even less likely that the NFIP would be able to pay claims even from the average loss year.

Key aspects of the viability of the NFIP are affordability, expansion of the policy holder base, and the *quid pro quo* with communities that manage flood hazard areas. Previous studies have shown that significant premium increases will lead to more people finding ways to avoid flood insurance and to drop existing policies. Further, in some areas citizens may pressure communities to drop out of the program entirely, which would lead to less floodplain management, more at-risk construction in flood hazard areas, and greater burden on the federal taxpayer through disaster assistance and casualty loss deductions on income tax returns.

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* Policy Information by State at http://www.fema.gov/business/nfip/statistics/pcstat.shtm; current Total Insurance in Force as of June 30, 2007 is $1,070,650,596,700.

Recommendations:

- Evaluate the effects on the NFIP, policyholders, and the federal taxpayer, of redesigning the program to accommodate catastrophic losses through creation of a reserve fund
- If, after study, a reserve fund is deemed appropriate, reduce the total amount to be collected, delay initiation of the fund, and require it to be funded over a period longer than 10 years
- Provide flexibility for the Director to direct income slated for the reserve fund to payment of claims in years that claims exceed income (i.e., payment of current claims takes priority over funding the reserve)
- Make clear that the a reserve fund shall only be used to pay claims on NFIP policies and associated expenses – it is vital that such a reserve, funded by only 5 million or so policyholders, be expressly protected from any and all other uses
- Provide that the reserve fund may be invested and the interest earned shall be deposited in the reserve fund (see similar language in 42 USC 4017 (Sec. 1310)).

G. IMPROVE THE NFIP'S FLOOD MAPPING PROGRAM

Upon completion of the initiative to modernize the maps, FEMA will need an ongoing program to review, update, and maintain the maps. Program authorization should make clear the ongoing nature and need.

Recommendations:

- Incorporate into the Committee's flood insurance reform bill the text of the National Flood Mapping Act of 2007 (S. 1938), introduced by Senator Reed of Rhode Island
- Clarify that the NFIP's mapping program is an <u>ongoing</u> effort necessary to maintain the maps and incorporate new data, notably new information related to levee locations and certification status and new data reflecting watershed development and other factors that increase flood levels
- Remove a limitation on state contributions to updating maps by striking language that specifies that such contributions may not exceed 50% of the cost; in Sec. 1360(f)(2) of the National Flood Insurance Act of 1968 (42 USC 4101(f)(2))

H. EXAMINE SEVERE REPETITIVE LOSS PILOT TO IDENTIFY BARRIERS TO IMPLEMENTATION

Recently, a growing number of ASFPM members and State Hazard Mitigation Officers are concerned that the Flood Insurance Reform Act of 2004 may have so constricted the program as to jeopardize implementation. (The State Hazard Mitigation Officers are those typically assigned the responsibility to manage FEMA's grant programs at the state level.) As part of the effort to improve the NFIP-funded mitigation programs, ASFPM urges the

Subcommittee to invite FEMA for a discussion of this program and the complexities and barriers to implementation. Several times in the last two years FEMA has implied that the regulations for this program were to be published and final comments accepted during the initial implementation period. This suggests there are ongoing difficulties that may, in part, stem from the language in the statute.

I. CLARIFY THE REPETITIVE CLAIMS PROGRAM

Clarify that the authority in Sec. 1323 for the Repetitive Flood Claims program is intended to allow FEMA to work directly with property owners, upon a finding that communities do not have the capacity to manage mitigation activities or in communities where the requirements of the NFIP's Flood Mitigation Assistance Program authorized in 1994 are not being met. Current NFIP-supported mitigation grant programs provide funds to communities – and thus successful projects depend on community participation. ASFPM has long supported community-based mitigation; however, we recognize that some repetitive loss properties are in communities that may not have the resources to participate. In order to achieve the goal of reducing the repetitive loss drain on the National Flood Insurance Fund, we urge that it be made clear that FEMA has the authority to work directly with certain property owners under this program, which was authorized at $10 million each year.

J. CLARIFY THE FLOOD MITIGATION ASSISTANCE PROGRAM

Under the Sec. 1366 Flood Mitigation Assistance Program (FMA), amend to:

- Clarify eligible activities by adding "demolition and rebuilding of properties to at least Base Flood Elevation or greater, if required by any local ordinance" to achieve consistency with the Severe Repetitive Loss program. FEMA has interpreted the difference in the two lists of eligible activities to mean that it cannot approve the measure under FMA. This creates unnecessary confusion and restricted options in communities, especially where the desire is to preserve tax base and improve liveability and community integrity. Elevation-in-place is a feasible measure for many buildings; however, for many older buildings and certain types of buildings, it is more feasible or cost-effective to demolish and rebuild a new building. The new building will be in full compliance with floodplain requirements and building codes which address fire resistance, energy efficiency, and where appropriate, resistance to other hazards such as hail, high winds, and seismic forces. The use of demo/rebuild would be restricted to areas other than high risk floodways and V zones.
- Clarify that the source of funds for FMA may be both policy fee income and premium income. Although the Congress stipulated only that the funds should be transferred from the National Flood Insurance Fund, FEMA has determined that funds for the Flood Mitigation Assistance program (Sec. 1366) can only come from the fee income to the NFIF, not premium income. The two newer repetitive loss programs (Sec. 1361A and Sec. 1323) can be funded by transfer from both fee and premium income. Report language could explain that it is the Committee's intent the FEMA fully fund this program and that both fee and premium income can be used.

- The Flood Mitigation Assistance program (Sec. 1366) has per state and per community caps established in the National Flood Insurance Reform Act of 1994 on the amounts that can be approved to resolve repetitive loss problems. Since the Reform Act of 2004 doubled the FMA authorization from $20 million to $40 million, those caps should be removed. The states and communities with the many repetitive loss properties and active mitigation programs are hitting their caps.

K. CLARIFY THE ADDITIONAL COVERAGE FOR COMPLIANCE WITH LAND USE AND CONTROL MEASURES (aka Increased Cost of Compliance (ICC))

ICC coverage (§1304(b)) was authorized by NFIRA94 and modified by the Reform Act of 2004. ICC coverage has been part of all policies on buildings in mapped special flood hazard areas since about 1997. In recent years total income associated with ICC premiums is estimated to exceed $72 million a year (premium ranges from $1 to $75 per policy). Total payouts are far less than total income. FEMA recently reported that approximately $167 million in ICC claims have been paid to settle 8,518 claims (another 3,223 claims are pending). FEMA has adjusted the maximum coverage twice; currently, the coverage is capped at $30,000.

- <u>Direct FEMA to Implement Section 1304(b) Paragraph 3.</u> This section authorizes FEMA to trigger payment of an ICC claim for properties that have sustained flood damage on multiple occasions if it is determined that it is cost-effective and in the best interests of the National Flood Insurance Fund to require the implementation of such measures. The original text was enacted in 1994 and amended in 2004. FEMA initially suggested that experience with ICC was necessary before implementing this provision – the agency now has 10 years of experience.
- <u>Direct FEMA to Implement Sec. 105 of the 2004 Reform Act.</u> Sec. 105 directed FEMA to pay ICC claims when an offer of mitigation assistance is made under FEMA's various mitigation grant programs. FEMA has not yet implemented this provision.
- <u>Increase Eligibility for ICC Payments When Used to Match Buyout Projects.</u> ICC claim payments can be assigned by the policyholder to communities so that the payment can be used as the non-federal cost-share of FEMA's various mitigation grant programs. For floodplain acquisition projects, FEMA has narrowly constrained cost elements that can be used to determine the amount of the ICC claim payment. It is our understanding that the average ICC claim payment for buyouts is on the order of $13,000 – far below the maximum coverage of $30,000. Despite FEMA's indication to ASFPM in 2004 of willingness to expand the cost elements of a buyout project that are used to determine the amount of the ICC claim payment, FEMA has yet to undertake such changes.
- <u>Direct FEMA to Submit the Study Required in Sec. 206 of the 2004 Reform Act.</u> Sec. 206 directed FEMA to study and report on the use of the cost of compliance coverage under section 1304(b), barriers to using the funds, and recommendations to address those barriers. This study was to have been submitted not later than 1 year after enactment.

- <u>Clarify When Payments of Additional Coverage for Compliance with Land Use and Control Measures (ICC) are Made.</u> FEMA has narrowly interpreted the statute to preclude payment of the ICC claim unless the damage that triggers "substantial damage" is solely due to flooding. Thus, homes that are damaged by both wind and flooding do not qualify for ICC unless the flood-related damage alone triggers the 50% rule. As modified in the Reform Act of 2004, the definition of "substantially damaged structure" at §1370(a)(15) does not support this position.
- <u>Technical Amendment.</u> Make a technical amendment in Sec. 1304(b) to replace (B) with the correct references to the Severe Repetitive Loss program (Sec. 1361A) and the Repetitive Claims Program (Sec. 1323).

L. DO NOT STUDY MAKING FLOOD INSURANCE AVAILABLE TO INDIVIDUALS IN NON-PARTICIPATING COMMUNITIES

The cornerstone that makes the NFIP more sound than many give it credit is the *quid pro quo* that communities must manage identified flood hazard through administration of local floodplain management ordinances and the flood provisions of the building codes in order for citizens to be eligible for federal flood insurance. Last year's bill included a GAO study "on the feasibility of allowing individuals residing in communities not currently participating in the NFIP to purchase flood insurance from the NFIP on an actuarially sound basis." ASFPM considers this would be the first step on a slippery slope that could reduce pressure on communities to join the NFIP (or prompt pressure for currently participating communities to drop out). If individuals could purchase flood insurance without community participation, a significant objective (land use controls applicable to new development) of the NFIP would be undercut.

M. OPPOSE EFFORTS TO ALLOW INDIVIDUALS TO "OPT OUT"

The proposal in the Flood Insurance Choice Act of 2007 (S. 1890) introduced by Mr. Lott of Mississippi would allow individual property owners to "opt out" of the requirement to purchase flood insurance, while acknowledging that doing so eliminates eligibility for other forms of disaster assistance. One consequence of not having flood insurance is a direct burden on the U.S. Treasury because uninsured losses qualify for a deduction as a casualty loss on income taxes (despite the fact that public flood maps should blunt characterizing flood losses as "unanticipated"). Most people find it difficult to fully understand low probability events – often referred to as the "it won't happen to me syndrome." Although a 1%-annual chance event may seem remote, floods of that frequency (and even lower probability) occur somewhere in the U.S. every year. It is common for us to hear variations of this misinterpretation: "we just had a 100-year flood, now we're safe for 99 years." Importantly, the occurrence of a big flood does not change the probability that another flood of equal or greater magnitude may occur at any time. Indeed, we've heard frequently-flooded property owners express misunderstanding of probability because they had experienced more than one flood that rose as high as or higher than the "100-year" flood in period of just a few years.

ASFPM strenuously opposes a provision in S. 1890 that would allow individuals who opt out of flood insurance to build new buildings without regard for the NFIP's base flood elevation requirements. The purpose of sound floodplain management is to reduce damage, not simply to avoid claims against the NFIP. Allowing blatant disregard for sound construction requirements, even under such limited circumstances, would severely weaken the premise of the NFIP and burden the general taxpayer because of greater exposure to disaster costs.

N. OTHER RECOMMENDATIONS

- Increase the civil penalties on lending institutions related to mandatory purchase requirements.
- Increase the maximum limits on coverage for both residential and nonresidential structures.
- Provide for optional coverage – at actuarially-rated cost – for additional living expenses and replacement cost of contents. EXCEPT: ASFPM does not endorse coverage for improvements in basements, crawlspaces, and other enclosed areas under elevated buildings, even at actuarial rates. For new construction and improved buildings, the NFIP rules do not allow such areas to be improved (finished and habitable). Providing even optional coverage would create a slippery slope that could lead to more illegal conversion of enclosures to uses other than those allowed by regulation and building codes. Such coverage will encourage owners to occupy below grade areas which are most at-risk of flood damage.
- Require landlords to notify tenants of the availability of federal flood insurance to cover their contents.
- Extend the Severe Repetitive Loss program authorized in Sec. 1361A to at least 2013 to preserve the intent that it be a 5-year program. Strike the limitation in subsection (l) so that all appropriated funds can be used to reduce the repetitive loss burden on the NFIP even if it takes several years.
- Authorization for additional FEMA staff. The salaries and expenses of a significant number of FEMA staff in the National Office and all ten Regional Offices who are involved with the NFIP are funded by policy service fees that are assessed on every flood insurance policy. As the NFIP policy base grows, and as the NFIP-funded mitigation grant programs are implemented, FEMA needs to be able to expand its staff to support the increased workload.

O. DO NOT EXTEND THE DEADLINE FOR FILING PROOF OF LOSS

The Director has authority to extend the filing period for damage claims, and does so for large events. There is no need to extend the period for all events, including minor floods. ASFPM is concerned that extending the period to file claims encourages owners to undertake repairs without permits. In addition, it could lead to postponing eligibility for NFIP insurance payment known as Increased Cost of Compliance, which provides owners whose buildings have sustained substantial damage with additional funds to to help pay costs associated with bringing the buildings into compliance, as required by regulations.

P. PROVIDE FOR DELEGATION OF FLOOD MITIGATION PROGRAMS ADMINISTRATION

FEMA is authorized to delegate to qualified states the administration of the post-disaster mitigation grant program authorized in the Stafford Act and known as the Sec. 404 Hazard Mitigation Grant Program. If selected states develop the capacity necessary for that delegation, it is appropriate that FEMA also delegate the authority to administer the NFIP-funded grant programs. ASFPM continues to focus on building state capacity. We believe that those states that have developed the capacity to assume program administration are in the best position to efficiently and effectively carry out the purpose of the reducing flood losses.

Q. RE-ESTABLISH THE TECHNICAL MAPPING ADVISORY COUNCIL

The National Flood Insurance Reform Act of 1994 created the Technical Mapping Advisory Council to make recommendations to FEMA on many aspects of improving the flood hazard maps and using technologies to accomplish that goal. The council, authorized for a period of 5 years, proved very valuable as FEMA developed and initiated the map modernization effort. ASFPM recommends that the council be reauthorized.

R. PROVIDE FOR DELEGATION OF MAP PROGRAM ADMINISTRATION

A number of states have had long-standing flood hazard identification and mapping programs – some even pre-date the NFIP. Many of those states are willing and able to take on more responsibility for the flood data and maps prepared under the map modernization and ongoing mapping efforts for the NFIP. FEMA has encouraged cooperative partnerships, executed mapping partnership agreements with some states, and implemented small-scale delegation of some functions. In order to move to more extensive delegation, ASFPM suggests that the Committee direct FEMA and the Technical Mapping Advisory Council to develop the necessary framework and metrics.

S. USE OF ADVISORY AND PRELIMINARY MAPS IN MAJOR DISASTER AREAS

The standard process that leads to adoption of revised Flood Insurance Rate Maps takes at least a year after preliminary maps are issued. When advisory or preliminary maps are issued for areas impacted by major disasters, it is in the interest of public safety, as well as in the interest of lessening confusion over where building standards apply, to either (1) give the FEMA Director discretionary authority to require NFIP participating communities to use the advisory or preliminary maps while the formal map adoption is ongoing, or (2) require that NFIP communities advise property owners and buildings who apply for building permits that if they do not use the advisory elevation information, they will have to pay actuarial rates for flood insurance once the new maps are adopted. ASFPM considers the latter option is less desirable because it appears likely to pose significant difficulties for insurance agents, mortgage lenders and policyholders.

In order to rebuild more safely after the catastrophic storms of 2005, it has been necessary that the NFIP utilize FEMA's advisory base flood elevation maps or the preliminary new flood maps. FEMA has issued guidance for its Stafford Act mitigation programs that requires use of the advisory flood maps, issued after the hurricanes of 2005, in any reconstruction utilizing federal mitigation funds. ASFPM supports linking the use of the new flood data to the availability and use of mitigation program funds.

T. INADEQUATE SHARING OF CLAIMS INFORMATION WITH STATE AND LOCAL NFIP COORDINATORS

Local floodplain management officials are responsible for making determinations as to when damage to floodplain buildings is substantial damage (when the cost to repair equals or exceeds 50% of the market value of the building). Substantially damaged buildings are to be brought into conformance with the requirements for floodplain development. Especially after floods that damage many buildings, this process can be difficult to manage. In 2001 FEMA issued a directive to claims adjusters to complete the "Adjuster Preliminary Damage Assessment" form when it appeared that damage may qualify as substantial damage (FEMA Form 81-109, OMB No. 1660-006).

It is not the responsibility of the adjusters to make the substantial damage determination, but they often are the first to evaluate damage and the collect information about the nature and extent of damage. The intention was that FEMA would forward the Adjuster Preliminary Damage Assessment forms to community officials to facilitate making the formal determinations. As far back as 1994 the Senate Banking Committee noted problems with lack of information sharing related to claims. Failure to share damage information causes a significant disconnect between FEMA's oversight role for local administration of floodplain ordinances and FEMA's role as the NFIP insurer.

U. TESTING OF NEW FLOODPROOFING TECHNOLOGIES

Dry floodproofing of residential structures is not allowed under the NFIP regulations or the International Building Codes. The primary rationale is related to safety of occupants if floodproofing measures fail or are overtopped by bigger floods than the event for which the measures were designed. There also are concerns about structural integrity of the typical residential construction and its ability to withstand the large forces exerted by floodwaters; this is particularly problematic for retrofitting older homes. In addition, the U.S. Corps of Engineers and Underwriters Laboratory, with input from ASFPM, have developed a testing protocol and standard for testing floodproofing products at the Corp's testing facility in Vicksburg, MS. The first product is in the process of being tested (costs covered by the manufacturer). Because of the presence of this standardized testing methodology, it is unnecessary to provide for construction of a noncompliant residential structure, even if such structure would be demolished at a later date (as was provided in last year's bill).

For any further questions on this testimony contact Larry Larson, ASFPM Executive Director at (608) 274-0123; Meredith Inderfurth, ASFPM Washington Liaison at (703) 448-0245; or Rebecca Quinn, ASFPM Legislative Officer at (434) 296-1349.

APPENDIX: QUESTIONS ABOUT WIND COVERAGE AND THE NFIP

In ASFPM's testimony before the Subcommittee on Housing and Community Opportunities of the Financial Services Committee regarding a proposal to add wind coverage to the NFIP, we raised 19 questions that we feel strongly should be answered before burdening the NFIP with a poorly framed approach (copied below). The NFIP resulted from many years of evaluation – rushing to address a poorly understood problem with an even more poorly understood "solution" likely will jeopardize the benefits that the program does provide. We are convinced that the wind provisions in H.R. 3121 would significantly affect the stability and functioning of the National Flood Insurance Program. The potential ramifications for over 5.4 million policyholders – and many millions more in the floodplain who should have flood insurance – are unknown, but can easily be assumed to be dramatic. The ramifications of a wind-generated catastrophe on taxpayers, who may already be faced with addressing the NFIP's debt, need to be assessed. Many questions need to be answered before proceeding.

ASFPM understands that consumers in coastal areas are faced with a growing problem of private insurance availability and affordability. We suggest that this problem needs thoughtful analysis and development of recommendations, perhaps in the context of overall provision for catastrophic losses. However, it is too big a step to simply offer Federal wind and flood coverage without analysis of the effects on consumers, on the insurance industry, and on the National Flood Insurance Fund.

The following is excerpted from ASFPM's July 17, 2007 testimony before the Subcommittee on Housing and Community Opportunities, House Committee on Financial Services

Our Primary Question is This: We are very aware that wind versus flood problems have arisen in the settlement of Katrina claims. But if the fundamental problem that prompts H.R. 920 is how the NFIP and private insurers do or do not collaborate to adjust claims to allocate wind and water damage, why is a statutory change required? Shouldn't administrative solutions be exhausted before determining that legislation is necessary?

We note that FEMA has recognized the wind versus water issue since at least the late 1970s and developed the "single adjuster" program to address it. As part of the comprehensive evaluation of the NFIP that was recently released by FEMA, a report titled "A Chronology of Major Events Affecting the National Flood Insurance Program" (December 2005) notes the following pertinent milestones:

> June, 1980: FIA's management explores ways in which the private insurance industry's state windpools can be used to assure prompt claims service in a major post-flood hurricane disaster. The Single Adjuster Program is established. In this voluntary program, individual windpools, or coastal plans, and the NFIP agree in advance on the use of single adjusters to adjust both the wind and water damage from hurricanes and to recommend the claim payments by each insurer for risks that both a coastal plan and the NFIP insure.

June, 1988: The Claims Coordinating Office (CCO) is developed to facilitate the entrance of multiple WYO companies into the Single Adjuster Program. When major storm events occur, a CCO will be established within Integrated Flood Insurance Claim Offices (IFICO) to provide a central clearinghouse for loss adjuster assignments and data sharing, for the use of WYO companies, coastal plans, and certain other property insurers willing to participate in coordinating a claims-oriented response to the catastrophe. Subsequent experience indicates that IFICO handle losses efficiently while coordinating activities with private sector windpool associations, WYO companies, and FEMA's Disaster Field Office and Disaster Assistance Centers.

September, 1989: The first major test of the Claims Coordinating Office (CCO) system occurs when a CCO is established to coordinate the assignment of a single adjuster to handle the wind and flood claims in North and South Carolina. The system works well and proves that cooperation between windpool and WYO companies through the CCO benefits insured individuals by simplifying the claims process with the use of a single adjuster. [emphasis added]

Other Significant Questions: In addition to the primary question above, ASFPM believes there are many other questions that must be answered prior to further consideration of the proposal in H.R. 920, including the following:

1. Congress created the NFIP to fill a gap – the private insurance industry declined to offer flood coverage. While private or state-supported wind coverage may be expensive compared to past pricing, reflecting high risk along the coasts, it is available. HR 920 makes wind coverage available in all of the nation's floodplains, not just coastal floodplains, in direct competition with the private sector. Is that the appropriate role for the Federal government?
2. How big is the potential market for Federal wind and flood insurance? What is the potential new loss exposure? How high would premiums for the wind coverage have to be to be "actuarial"?
3. Sec. 2 includes a section on "Nature of Coverage" that specifies it is to cover losses from flooding or wind. This makes it unclear whether any property owner in the Nation would be able to purchase the new wind coverage – or would it be available only for buildings that are located in floodplains?
4. Would there be a separate fund to collect the premiums for this coverage – or would premiums collected from flood-only policies be tapped to pay wind-only damage?
5. Would the Federal wind and flood program be authorized to borrow from the U.S. Treasury to cover shortfalls?
6. The insurance industry spends millions to develop assessments of risk in order to set rates for wind insurance. Does the bill anticipate that the Federal government would have to undertake similar studies? How will the cost of conducting those assessments be paid?

7. While it seems simple to say that H.R. 920 is revenue neutral because it calls for actuarial rates, in fact, without loss experience with a combined wind and flood policy, how would FEMA develop appropriate rating for the wind coverage? Would FEMA require additional staff for this purpose and to administer the new type of policy?

8. Is the new wind coverage supposed to cover wind damage even if there is no associated flooding (e.g., microbursts, tornadoes, hurricanes, nor'easters, etc.)? Would hail damage be included? If no flooding was involved, would a floodplain home in Tornado Alley that suffers damage from a tornado be covered? Would any floodplain home that has a tree blown onto it or shingles blown off by high wind be covered?

9. Insurance companies pay a lot to cover claims due to rain intrusion into buildings after high winds have damaged roofs and windows. Is it anticipated that this type of damage is "wind damage" that would be covered?

10. Would the private insurance industry be likely to develop a homeowner's policy that covers fire and other liabilities, but excludes wind damage – or would homeowners have to buy two policies, one homeowner's policy with wind and other standard coverage and one to cover wind and flood damage? What assurance is there that the combined coverage would be comprehensive?

11. Flood insurance is mandatory when a mortgage is federally regulated or insured, but the multi-peril coverage is optional. The cost of setting up entirely new coverage seems very high, given no guarantee that property owners will opt for this combined coverage. Who would pay for the up-front investigations and administrative costs? Wouldn't it be unfair to expect the NFIP to pay for it out of policy service fee income charged to current flood insurance policy holders?

12. Under the NFIP, "actuarial rates" are charged on "post-FIRM" buildings (built after adoption of a Flood Insurance Rate Map and floodplain management ordinance). To rate policies for post-FIRM buildings, homeowners provide surveyed elevation data so that the insurance agent can write the policy based on risk. Does the bill anticipate that owners of older buildings will have to provide some form of certification that the home meets certain wind resistant construction methods in order to determine appropriate, actuarial rates for wind coverage? What would it cost a homeowner or business to have such a certification prepared by a qualified engineer or architect?

13. Isn't it contradictory and confusing that the bill would simply "encourage" adoption of adequate mitigation measures, while requiring "effective enforcement measures" as a condition of community participation? There would be nothing to enforce if mitigation measures were not adopted.

14. Sec. 5 calls for the Director to determine appropriate land use, zoning and damage prevention measures. This would seem to call for a new "Federal building code." Would communities be required to adopt such a new "Federal building code" to require construction to meet certain wind resistant standards? How would a community handle conflicts between such a new Federal building code" and currently adopted State or local building codes?
15. Sec. 2, Limitations of Amount of Coverage, specifies that the liability is the lesser of replacement cost or specified amounts. The NFIP statute does not currently specify "replacement cost." Would the flood coverage be expected to change to match?
16. The bill specifies coverage limits which are different than those specified elsewhere for flood insurance (e.g., $500,000 versus $250,000 for structure coverage for residences). If a house covered by a Federal wind and flood policy sustains just flood damage, do the new limits mean the flood-only claim could exceed the limits specified in statute for flood insurance?
17. The bill specifies business coverage for business interruption based on loss of profits, with a maximum coverage of $750,000. If a business covered by a Federal wind and flood policy sustains just flood damage, does the new coverage mean a business could receive a flood-only claim payment to cover loss of profits?
18. The bill uses the term "windstorm zoning" that is not used by land use planners. Zoning typically identifies allowable uses in different areas of a community. Is it anticipated that local jurisdictions would be required to adopt "windstorm zones" that might limit uses of land exposed to high wind risk, such as open shorelines? Who would undertake the analysis to identify those zones and who would pay for those analyzes?
19. How would the NFIP compliance responsibilities of lenders be affected if a mortgagee initially elects the new Federal wind and flood coverage, and then subsequently drops the wind coverage?

TESTIMONY OF DONALD L. GRIFFIN
BEFORE
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
CONCERNING
THE NATIONAL FLOOD INSURANCE PROGRAM
ON BEHALF OF
THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

October 2, 2007

My name is Don Griffin and I am Vice President of Personal Lines for the Property Casualty Insurers Association of America. PCI is a trade association representing over 1,000 property/casualty insurers. Of the 88 companies in the NFIP's "Write-Your-Own" program, 57 are PCI members. Our members write almost 47 percent of the WYO flood business.

Thank you, acting chairman Carper, ranking member Shelby and members of the Senate Banking Committee for the opportunity to appear before you today on behalf of PCI and to present our views on the National Flood Insurance Program (NFIP) and how this federal program could be improved.

Introduction

The committee requested comments on five key areas:

- The current status of the NFIP;
- Any proposals to strengthen and reform the NFIP;
- The effectiveness of the NFIP in providing coverage to those most at risk;
- The status and adequacy of the flood maps and the map modernization program; and
- How to ensure that people in flood-prone areas purchase flood insurance.

PCI believes that the National Flood Insurance Program is a necessary public policy response to an uninsurable peril and should be continued. It has undergone significant changes over the years, and as it approaches its 40th year, it continues to provide vital protection to policyholders nationwide. However, the program as currently structured does not provide the level of protection needed by consumers and has not achieved the breadth of participation (i.e., the take-up rate) needed. Greater participation in the NFIP and program reforms are essential so that our nation can prepare for and respond to future catastrophic events.

Current Status

The events of 2004 and 2005 have shown that the devastation caused by hurricanes and floods can impact millions of lives, businesses and our nation. Even as those hardest hit continue to recover from these events, scientists and meteorologists tell us we will continue to see more frequent and more severe storms for another 10 years or more.

Significant reforms were made to the NFIP following the passage of the Flood Insurance Reform Act of 2004. This important legislation (P.L. 108-262) contained several key provisions that help policyholders and claimants better understand their purchase and what is covered by a flood policy, including how to file a claim and, if necessary, an appeal of that claim. This legislation also included a pilot program to "buy-out" severe repetitive loss properties and facilitation of the flood map modernization program.

Unfortunately, these informative materials were not ready for distribution when the Hurricanes Katrina, Rita and Wilma hit in 2005. The NFIP policyholder disclosures, claims handbook and the appeals process are now complete, and we believe that these reforms will be beneficial when the next major flooding event occurs. However, the severe repetitive loss program was not funded until 2007 and the map modernization project is not yet complete. Also, according to a recently released GAO report, as of May 2007 the NFIP has had to borrow more than $17.5 billion to pay its losses from the events of 2005. This is more than in its prior 36-year history for paid losses which, again according to the GAO, totaled $14.6 billion.

Proposals to Strengthen and Reform the NFIP

We believe that there are several key issues that must be addressed to make the NFIP: 1) more responsive to purchasers, 2) fiscally responsible, and 3) better able to ensure that properties built or rebuilt are protected against future losses. Of the numerous elements that should be part of any reforms to the program and we believe the most important are as follows:

- First and foremost, we encourage Congress to forgive the outstanding debt incurred by the NFIP as a result of Hurricane Katrina and ensure that the NFIP has the ability to access funds when needed without constantly coming back to Congress (as was necessary in 2005 and 2006) to increase its borrowing authority, needlessly slowing the claims-paying process to those who need it most, those with flood claims.

  We believe that this is an extremely important step toward moving forward. The GAO reports that the "interest-only" payments on this debt will cost more than $900 million annually. The NFIP will collect about $2.5 billion in premiums in 2007. The costs of the program, paying for events during the year and the fact that the NFIP will need new loans about every six months to cover the annual interest alone means that, given its current premium base, it is unlikely that the NFIP will ever be able to retire this debt.

- The program should be reauthorized on a long-term basis (e.g., for 10 years) as the current program will expire on September 30, 2008. This will ensure that there will be no gaps, such as occurred at the beginning of 2004, in making the protection available to purchasers and policyholders and provide for the smooth operation of the program.

- In order to reduce litigation which significantly raises operational costs for all stakeholders including the federal government, Congress should affirm federal court jurisdiction over all disputes relating to procurement of a policy and adjustment of claims under the NFIP.

- The program should include revised and enhanced mitigation efforts such as encouraging adoption of a strong, statewide minimum building code that considers all the risks of loss (including, for example, life safety and wind-borne debris for hurricanes) due to natural disasters and that cannot be weakened by local jurisdictions, as a condition for federal disaster assistance being provided to a community. Land-use programs should also be evaluated as we cannot continue to over-develop and rebuild in areas subject to such high potential for loss.
- The maximum coverage limits should be increased above current $250,000/100,000 limits for residential property to accommodate increasing property values. The last time these limits were changed was in 1994. The limits offered should facilitate replacing the average home based on today's construction costs.
- FEMA should be given more flexibility in determining rate changes as well as charge pre-FIRM properties, either through a phase-in period or when the property changes ownership, risk-based, actuarially-sound rates.

Effectiveness of the National Flood Insurance Program
The program does not provide the same level of coverage that is found in the private marketplace (e.g., no additional living expense coverage) and the number of purchasers of the product by those who need it are too low.

Every time Congress "reforms" the flood program, they have attempted to strengthen the requirements for the purchase of flood insurance. However, these requirements have had limited success. For example, in New Orleans, only 39 percent of property-owners carried flood insurance when Katrina hit, so many of those that needed the program most did not have this important protection. A recent report by the RAND Corporation states that only about half of those that are required to purchase a flood policy actually do so.

However, this does not mean that the program is ineffective or that there hasn't been growth. One of these growth periods was following the 1983 establishment of the "Write-Your-Own" program. This program continues to make it easier for consumers to purchase and lenders to enforce the purchase of flood insurance. However, with the growth in the "secondary mortgage market", where mortgages are packaged and sold, we believe that sometimes the required purchase falls through the cracks.

Also, consumers must be better educated and realize that just because you are not required to buy flood insurance doesn't mean that you will not experience a flood loss. Unfortunately, all too often the purchase decision goes as follows: Am I required to purchase flood insurance by my lender? If the answer is no, then the purchase is not made, despite the recommendation of the agent or insurer.

Another period of growth always follows a major disaster. For example in the last two years, the NFIP has experienced double-digit growth in the number of property owners purchasing flood insurance. However, as is also typical, as time passes without another event, so does the perceived risk and the number of policyholders diminishes.

Because the product is complex, difficult to sell and difficult to understand, it may be less effective based on concerns about litigation on the part of the agent or insurer and lack of consumer interest.

Finally, as mentioned previously, the product does not provide the same level of protection as is found in the private market under a homeowners policy. This leads to further confusion, uninsured damages and claims disputes following a major flooding event.

We believe there are several reforms that would improve the effectiveness of providing the product to those most at risk:

- The Standard Flood Insurance Policy should be revised and rewritten to make it more consistent with standard homeowners and other property/casualty insurance products.
- The program should include at least some coverage for additional living expenses, business interruption coverage and the option to insure all buildings to their replacement cost value.
- The program should provide more educational materials and strengthen requirements for the purchase of flood protection.

The Flood Maps and the Map Modernization Program
The flood maps are outdated, and oftentimes it is difficult for an agent, insurer, or third party to locate the property's exact location on the Flood Insurance Rate Map (FIRM). We believe that:

- Reform legislation should provide additional federal funds to expedite completion of the Map Modernization initiative.
- Reform legislation should include a flood insurance purchase requirement for properties located in areas behind a levee or other man-made protective barrier (i.e., in the "natural floodplain") and those areas should be easily identified on the flood maps.

How to Ensure the Purchase of Flood Insurance
We all have a duty to provide consumers with the best information possible so that they can make an informed decision. However, purchase decisions are often based on a consumer's belief that this type of event "just won't happen to me." Because the human and financial costs that follow such decisions are so great, we recommend that:

- The program expand the mandatory purchase requirement to include additional properties at risk, including properties that have sustained a flood loss, properties that are located behind a levee or other protective barrier (as stated above), or that are located within a specified distance from the coast or major body of water. Mandatory purchase requirements should not be limited only to those properties located in Special Flood Hazard Areas (SFHA).

- The program should encourage lenders to establish escrow for flood policies outside the Special Flood Hazard Areas, thereby making it easier for property owners to purchase the product.
- FEMA should change its disaster assistance procedures to make sure that those with flood insurance are paid ahead of those who have not purchased flood insurance. As an example, those without flood insurance were often provided funds from the federal government ahead of those who purchased the coverage, sending the wrong message to citizens and perhaps encouraging some to abandon the purchase of flood insurance in the future.

Conclusion

Again, thank you for the opportunity to present our views on this important issue and we commend the Chair and the Members of this committee for holding this important hearing.

In summary, it has been mentioned in the past, but it should be reinforced, that the National Flood Insurance Program provides important catastrophic protection for our nation's property owners. While it needs significant reform, we are encouraged that you are looking for ways to improve it and we look forward to working with you and members of Congress on this important issue.

Donald L. Griffin, CPCU, ARC, ARe, ARM, AU
Professional Experience/Information

Don Griffin is vice president, personal lines for the Property Casualty Insurers Association of America (PCI). PCI is a national property and casualty trade association with more than 1,000 member companies that write almost 40 percent of the nation's automobile, homeowners, business and workers compensation insurance.

Don's current responsibilities include policy development and issue identification as member liaison for the personal and commercial property, catastrophe, automobile insurance and service contract reimbursement areas. He is PCI's point person in Des Plaines on catastrophe and flood insurance issues. He has over 25 years of experience in the property and casualty insurance business including management responsibilities at both agency and company levels.

In 2004, he helped form the "WYO Flood Insurance Coalition". This coalition includes more than 80 of the WYO companies writing about 95 percent of the flood insurance premiums through the WYO program. The coalition includes representation from the national property and casualty trade associations, their members, independent national companies and the Institute for Business and Home Safety. He is the coordinating leader of this coalition that works on federal and state legislative issues related to the flood program.

Prior to joining PCI, he worked for the attorney-in-fact of a reciprocal exchange, the California Casualty Indemnity Exchange group based in San Mateo, California. As Assistant Vice President in the product development area, he drafted policy language, coordinated company-wide compliance projects and filed both forms and rates with various state insurance departments. He served as risk manager and purchased the corporate property and casualty insurance as well as the reinsurance for the group.

His past insurance experience also includes profit and loss responsibility for personal lines at Hall's Insurance Agency, Inc., a mid-sized independent insurance agency in southeast Texas with more than 6,000 personal lines clients. This agency was also the largest agency writer of flood insurance in the state.

He is a member of the Society of Chartered Property Casualty Underwriters, and holds the Associate in Regulation and Compliance, Associate in Reinsurance, Associate in Risk Management, and Associate in Underwriting designations.

Statement of

Gerald E. Galloway, PE, PhD[1]

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Water Policy Collaborative[2]
University of Maryland, College Park, MD 20742

To the

Committee on Banking, Housing, and Urban Affairs
US Senate
October 2,, 2007

The National Flood Insurance Program

Members of the Committee. It is a distinct privilege to participate in this important and most timely hearing and I want to thank the Committee for the opportunity.

I am Gerald E. Galloway, Glenn L. Martin Institute Professor of Engineering at the University of Maryland where I teach and do research in water resources and public policy. I served as the co-PI of the of a study of the adequacy of the 1% standard for the National Flood Insurance Program (NFIP) conducted for FEMA by the Water Policy Collaborative at the University of Maryland, and as chairman of the Federal Interagency Levee Policy Review Committee, which recently submitted a report to FEMA on levee issues within the NFIP.

Recommendations

I am here today to urge the committee to:

- Support the continuation of the flood map modernization program being conducted by FEMA and its local partners under the National Flood Insurance Program (and as proposed by S. 1938), and the movement of national mapping from flood insurance rating to the mapping of risk in flood hazard areas.

- Extend the zone for mandatory purchase of flood insurance under the NFIP from the 100 year (1% annual chance) flood zone to the 500 year (0.2% annual chance) flood zone.

- Extend the zone for mandatory purchase of flood insurance to include areas behind levees subject to a residual risk of flooding.

The NFIP

The NFIP is a key component of the nation's flood damage reduction program. It provides a significant federal incentive for communities in or with part of the community in the floodplain to assume responsibility for wise use of those areas. An effectively managed NFIP, supported by lender compliance, effective communications, and appropriate incentives for participating communities, makes a difference in the reduction of flood damages across the nation. Reforms in the program dating back to 1994 are continuously improving its efficiency.

Across the nation there are millions of structures at risk to flooding. Some are in the floodplain or along the coast and have little direct flood protection. Others are behind levees or other structures and subject to the residual risk of levee or structure failure or overtopping. When a major flood occurs and significant property damage occurs, history has shown that the federal government has been there to cover the exposure. When properties have been insured under the NFIP, the costs to the government are reduced by the premiums paid by the insured over time. It is essential that flood hazard areas be identified and that those at risk in these hazard areas share in the responsibility for and funding of post-disaster mitigation through participation in the NFIP.

Extension of Mandatory Flood Insurance to the 500 Year Floodplain

The current standard for mandatory insurance under the NFIP is the 100 year floodplain (1% annual chance floodplain). There is a 26% chance that a 100 year or larger flood will occur within the lifetime of a 30 year mortgage on a property in that floodplain. If the information about the floodplain is sketchy, the odds can rise even more.

As we indicated to FEMA in the report on the adequacy of the1% standard[3]:

> Requiring insurance to the 1 percent standard does not provide for coverage for the significant amount of property at risk in the floodplain between the 1 percent line and the 0.2 percent line. Purchase of flood insurance should be mandatory for those living in the 0.2 percent floodplain if they hold a federally insured mortgage or if they are to receive any disaster assistance from the federal government in the case of a flood. The cost of this insurance should be determined actuarially, based on the reduced risk of living at a specific elevation within the 0.2 percent floodplain.

Our report noted that, in areas where detailed flood studies have been completed, there are estimated to be 2-4 million structures in the 100 to 500 floodplain. In areas where only approximate studies have been completed, estimates indicate that there are 1.5 to 3 million structures in the 100-500 year floodplain. Taken together, the total could be 3-7 million structures at risk. Requiring actuarially based insurance for those in this zone would not impose a significant financial burden on property owners as the risk in this latter zone is considerably less, but would greatly reduce the exposure of residents and of the federal government to losses from a significant event. For an individual family, a single flood can ruin a college savings plan, plans for retirement, or deplete lifetime savings. Many people in the New Orleans area did not have flood insurance, and one can only speculate that the recovery would be further along today if, rather than waiting on some other special program, they had had the benefit of a faster payout of flood insurance. In short, the 100-year (1%) standard is an inadequate guide for the imposition of mandatory insurance in the floodplain and falls short of what we routinely expect for other hazards most notably fire.

Extension of Mandatory Flood Insurance to Those behind Levees

FEMA currently accredits levees with a 100-year protection as sufficient to remove the area protected by the levee from the requirements for mandatory purchase of flood insurance and imposition of land use regulations. This is too low a standard for areas where large numbers of people and/or high value property are at risk. Both the study on the adequacy of the 1% standard and the report of the Interagency Levee Policy Review Committee[4] recommended that levees protecting urban areas be accredited at the 500 year level. These recommendations follow the recommendations of earlier studies dating back as far as 1982 and internal recommendations of the US Army Corps of Engineers

(USACE) and FEMA from that same period. The Association of State Floodplain Managers (ASFPM) and the National Association of Storm and Floodwater Management Agencies (NAFSMA) also support this recommendation.[5]

As we learned in New Orleans and in earlier significant floods, structures do fail. Many of the structures we now have protecting millions of Americans are of unknown or marginal integrity. A major flood in California's Central Valley could overtop the levees in Sacramento and subject the capital of California to billions of dollars in damages. Efforts are already underway to improve protection for California and other areas. There will always be a residual risk of failure or overtopping of levees and other structures. Unfortunately, many people who live behind these levees and structures see them as absolute protection, when in reality, should a significant flood event occur, they would be subject to inundation, property damage and, conceivably, loss of life. Requiring those behind levees to obtain flood insurance informs them of their risk, reduces the impact on these individuals should a such a flood occur, and limits the exposure of the federal and state government in terms of the assistance and indemnification they must provide.

Mapping the Floodplain

This leads me to my third point, the importance of floodplain mapping. The key to effectively dealing with a flood hazard is to know where it is, what the consequences of a flood event might be, and the risks associated with such an event.

The FEMA Map Modernization Program has been a major step forward and has been long in coming. It is difficult for federal, state, and local governments to effectively manage the floodplain if they do not know accurately where it is. I should note that the title should not be map modernization but map modernization and maintenance, for the work of a floodplain mapper is never complete. The federal government may well be able to provide a community a new digital map, but that map starts going out of date the minute it arrives. The local community, with support from federal and state governments, must ensure that it remains up-to-date.

Prior to the institution of the map modernization program, communities were forced to deal with inaccurate mapping of the floodplain and with limited updates in a program that was tied to the tedious and time consuming process of producing paper maps. Establishing a digital environment offers the nation access to maps that can be rapidly updated and easily produced. New techniques in mapping offer the opportunity for increased accuracy.

In carrying out the map modernization program within the funds available, FEMA has taken several approaches in preparing its digital products:

- When available, it has taken advantage of updated topographic, hydrologic, and hydraulic data to better define the floodplain.

- In the case where the map included a levee, it has paused to examine the information that was available about the levee to determine if its accreditation of the levee should be continued. In carrying out this work, FEMA has determined that many levees are of marginal integrity or lack information on how their original entry in the program was justified.

- In some cases it has digitized an existing paper map with little change in the information contained therein.

The accuracy and the utility of a flood map totally depend on:

- The quality of the topographic information used as the base for the map. Where topographic information has been gathered digitally, its utility depends on its resolution. In very flat areas, where a few feet in elevation make a tremendous difference in the extent of the floodplain, high-resolution data is critical but not always available. New techniques such as LIDAR (Light Detection and Ranging) make the gathering of such data more feasible but also more costly.

- The quality (age and accuracy) of the hydrologic and hydraulic data about the area and its watershed.

- The quality and currency of the models that transform base data into flood elevation information and ultimately create maps.

- The availability of information concerning flood damage reduction structures that result in hazard areas being removed from the NFIP regulatory requirements.

Much of the nation's hydrology and hydraulics information is out of date. As the Levee Policy Committee noted:

> The determination of the height of the1-percent-annual-chance flood requires extensive H&H computations and reliance on baseline H&H data concerning the area under study. Approximately 45 percent of levee designs and flood risk determinations are based on precipitation frequency estimates that are as much as 45 years old. Approximately the same percentage of designs and determinations are based on flow frequency guidelines that are at least 25 years old. Many communities lack long-term streamflow records.

Maps will not be accurate if they are not based on sound data. Support of map modernization must also address the needs of NOAA and USGS for funding of needed data collection and monitoring.

In addition, even where current H&H information is available, the challenge becomes the consideration of what changes may occur in the future. Changes in hydrology brought about by climate change or variability can increase the flow in rivers and raise the flood level. Sea level rise and upstream development that increase runoff do the same thing. The reports of the 1% study and the Levee Policy Review Committee indicate that future conditions should be taken into account in the production of new digital maps. Another report of the NFIP evaluation program, *Managing Future Development Conditions in the National Flood Insurance Program,* points out the monetary savings that can accrue from mapping possible future conditions in a watershed.[6]

It is interesting to note, that the USACE, in its work on the post-Katrina restoration of New Orleans levees to the 100-year protection level is taking into consideration sea level rise and future subsidence in the design of the levees that are being built.

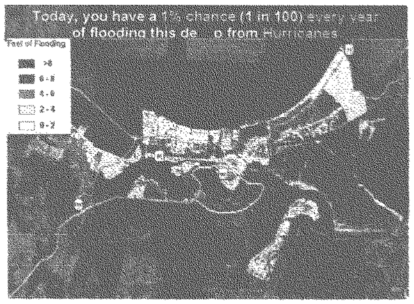
Identifying Risk vs. Hazard

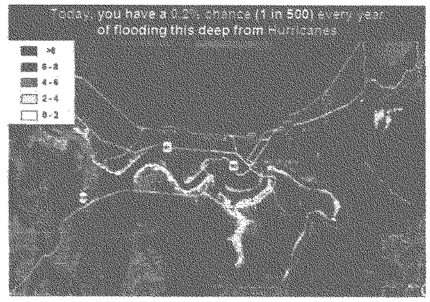
When all of these factors are taken into account, topography, H&H, structures, and future conditions, a sound and effective flood rate map will be produced. However, it maps only one (100-year) or two (100-year and 500-year) elevations on a continuum of flood elevations. FEMA defines flood maps as a series of flood insurance rate maps providing floodplain delineations. CFR 59.1 indicates that a flood insurance rate map (FIRM) is an "official map of a community, on which the Administrator has delineated both the special hazard areas and the risk premium zones applicable to the community."

A flood insurance rate map is not a risk map. It does not identify the relative risk or specific information about the flood hazard. It does not identify the consequences of flooding in the mapped zone. People, who live behind a levee in a floodplain that would be subject to 10 to 20 feet of inundation, see the same thing on a current flood insurance rate map as those who live with only their foundations at risk. Those living behind a levee whose condition is questionable receive no information about the probability that the levee will not perform as intended.

USACE defines risk, in the simplest of terms, as the likelihood of loss of life or property as a result of flooding. Risk analysis incorporates information about the hazard itself, the system (levees, floodwalls, floodways, dams, etc.) associated with the mapped areas and the probability that the system may not perform as designed, and the consequences that will occur should the flood exceed the level of protection provided or should the system fail.

Describing risk on a map is not a simple process, but one that must be accomplished if the public is to know and understand the challenge that it faces living in a flood hazard zone. USACE, in coordination with FEMA, has been working diligently in the New Orleans area to develop various types of flood risk maps and recently published maps that indicated that depths of inundation in various areas in New Orleans should certain floods occur. These maps take into account the performance of the protection system, allowing for the probabilities of overtopping or failures. Two such maps are shown below:





USACE has also developed maps that indicate the consequences of flooding under various scenarios-not just a 1% flood. These maps and others can be found at http://nolarisk.usace.army.mil. This is pioneering work and USACE, FEMA and their federal partners are to be complimented for these efforts.

In its report to FEMA, the Levee Policy Review Committee, recommended the institution of a risk designation for levees that would be based not only on the evaluation of levee or system integrity but also on the potential depth of flooding in the event of failure or overtopping, the type and density of development in areas behind the levee, possible warning times for evacuation and the number and types of egress that would permit those at risk to evacuate the area. The committee proposed that this levee risk classification be designated on the Flood Insurance Rate Map (FIRM) and in the Flood Insurance Study (FIS) report.

It is clear from the language of S. 1938 that the Congress is interested in seeing more than maps that depict only the 100 year flood and that provide no indication of risk. The proposed legislation indicates that risk must be considered in the mapping process. If this is to take place, then a new initiative must be launched as part of the national effort to reduce flood losses through effective mapping.

FEMA and USACE have worked closely on the mapping of New Orleans and are now working together in California's Central Valley. They have also become partners in the development of a national levee inventory. This cooperation has brought the resources of both organizations and those of NOAA and the USGS together to deal with challenging problems in data gathering, elimination of program overlaps, and development of new techniques. This cooperation needs to be extended into the development of flood risk maps for the nation.

It is important that the Congress has recognized the necessity for this move forward and support the coordinated efforts of all participating agencies to improve the provision of risk information to the public.

Before leaving risk, I would like to comment on a disturbing series of events. In the preparation of new flood maps, FEMA has determined that it should place a cautionary note on maps containing levees in order to alert those behind the levees of the possible risks they must face. There was a clear perception by many in New Orleans prior to the hurricane that they were living behind levees and therefore did not face any risk. The proposed FEMA note that would be placed on new maps indicates:

> WARNING! This area is shown as being protected from the 1-percent-annual-chance flood hazard by levee, dike, or other structure. Overtopping of failure of this structure is possible, which could result in destructive flood elevations and high-velocity floodwaters. There is a chance that large floods will occur that are greater than the level of protection provided by the levee. Communities should issue evacuation plans and encourage property owners behind these structures to purchase flood insurance, even if the structure is currently shown as providing protection for the 1-percent-annual-chance flood.

I understand that some members of the House of Representatives are concerned that such a note overstates the risk and should be modified or eliminated. While I have great faith in the integrity of many levees in this country, I cannot say that the possibility of failure does not exist with the same levees. We learn every day of new challenges to the systems. Informing those behind levees of their situation should not create economic chaos or cause people to want to leave an area where they have long lived. The knowledge of the possible challenge simply allows them to make informed decisions and to prepare for a possible, conceivably very rare, event. I would suggest that the people at risk should have the information and make their own decisions as to what to do with the information.

National Technical Mapping Council

S. 1938 also calls for the reestablishment of the National Technical Mapping Council and I strongly support that measure. While FEMA and USACE have strong professional and technical competencies, both agencies would benefit from the advice of professionals in the mapping field. Both agencies already have extended outreach to technical expertise, but the establishment of the Council will facilitate continuous exchange between all parties.

In Summary

FEMA is to be complimented for its efforts to continuously improve the quality of the flood insurance rate maps it is now producing under the Map Modernization Program. It has recently chartered the National Research Council of the National Academies to conduct a study, *FEMA Flood Maps: Accuracy Assessment and Cost-Effective Improvements*, that will examine approaches reducing the cost and improving the accuracy of flood mapping. I urge the continued support of the Mp Modernization Program.

USACE's efforts, stemming from the work of the Interagency Performance Evaluation Task Force examining the causes of New Orleans flooding, have developed new techniques and procedures that will guide risk identification in the decades ahead. These efforts have received considerable attention from and the support of the professional community. I also urge the Congress to continue support of these programs.

In closing, let me compliment the committee for its attention to the issues of floodplain management and the NFIP in general, and floodplain mapping in particular. The proposed legislation on floodplain mapping provides strong support for continuation of a program that is critical to our efforts to reduce national flood losses and to protect the health and safety of our citizens.

Thank you again for the opportunity to be here today.

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[1] Gerald E. Galloway is currently Glenn L. Martin Institute Professor of Engineering and an Affiliate Professor in the School of Public Policy, at the University of Maryland He is also a Visiting scholar at the US Army Institute for Water Resources and a consultant to several organizations. Previously, he served as secretary of the United States Section of the International Joint Commission in Washington, D.C. He has been a consultant to the Executive Office of the President, and has assisted the U.S. Water Resources Council, World Bank, Organization of American States, Tennessee Valley Authority, U.S. Army Corps of Engineers and various other organizations in water resources related activities. He was appointed by President Reagan to the Mississippi River Commission and served on the Commission for seven years. Following the disastrous 1993 Mississippi Flood, he was assigned to the White House and led an interagency study that investigated the causes of that flood and made recommendations to improve the nation's floodplain management. He commanded the Army Corps of Engineers District in Vicksburg, Mississippi from 1974 to 1977 and has served on the faculty of the U.S. Military Academy at West Point. In 1990, he was promoted to Brigadier General and appointed the ninth Dean of the Academic Board (Chief Academic Officer) of the Military Academy. He retired from active duty after a 38 year military career. Dr. Galloway holds master's degrees from Princeton, Penn State, and the U.S. Army Command and General Staff College. Dr. Galloway received his Ph.D. degree in geography from the University of North Carolina. Dr. Galloway is a member of the National Academy of Engineering, a fellow in the American Society of Civil Engineers and an Honorary Diplomate of the American Academy of Water Resources Engineers and a registered professional engineer in New York.

[2] The Water Policy Collaborative is a gathering of scholars and practitioners brought together virtually to address national and international water resources policy challenges and to support other activities to improve the quality of decision making on critical water resource issues. Its membership includes a wide variety of disciplines and individuals located at organizations across the United States. It is hosted and sponsored by the A. James Clark School of Engineering, the School of Public Policy and the College of Behavioral and Social Sciences, University of Maryland. It may be contacted at 1173 Glenn L. Martin Hall, College Park, MD 20742.

[3] *Assessing the Adequacy of the National Flood Insurance Program's 1 Percent Flood Standard.* Galloway, Baecher, Plasencia, Coulton, Louthain, Bagha, and Levy, Water Policy Collaborative, University of Maryland. Available at http://www.fema.gov/business/nfip/nfipeval.shtm.

[4] *The National Levee Challenge: Levees and the FEMA Flood Map Modernization Initiative.* Report of the Interagency Levee Policy Review Committee. Washington, DC. September 2006. Available at http://www.fema.gov/plan/prevent/fhm/lv_intro.shtm.

[5] Joint Recommendations on Levee Policy Developed by ASFPM and NAFSMA from Discussions at the Flood Risk Policy Summit of December, 2007. ASFPM/NAFSMA, May 2007.

[6] *Managing Future Development Conditions in the National Flood Insurance Program.* Blais, Nguyen, Tate, Dogan, and Petrow, ABSG Consulting; and Mifflin and Jones. Available at http://www.fema.gov/business/nfip/nfipeval.shtm.

Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

TESTIMONY OF

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

BEFORE THE

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

REGARDING

AN EXAMINATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

October 2, 2007

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). CFA is a non-profit association of 300 organizations that has sought to advance the consumer interest through research, advocacy, and education since 1968. 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 1970s.

A. THE UNDERLYING PRINCIPLES OF THE NFIP ARE SOUND

Congress wisely based the program on two fundamental principles:

1. The program would discourage unwise new construction through the enactment and enforcement of sound land-use policies, enforced at the local level, so that over time, taxpayer subsidies for flooding would be greatly reduced; and

2. Owners of existing structures would receive affordable flood insurance through early program subsidies, which would be eliminated over time as the buildings were retired from use because of aging or damage. These buildings would then have to be elevated or relocated under the program's rules.

When I testified before you on February 2, 2006, I told you that if the program had worked as Congress intended it to work, it would be a blessing to the nation. A workable program would ensure that new construction in areas prone to flooding is wise and would provide affordable coverage to all Americans exposed to high flood risk. The program would not allow unwise construction in the highest risk velocity ("V") zones and would require that buildings be elevated to the true 100-year flood line, at least in the other high-risk ("A") zones.

However, if the program encourages unwise construction in flood plains, it is a danger to the nation rather than a blessing. If the program lures people into flood plains; 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. Or, it must be abolished.

B. FEMA ADMINISTRATION OF THE NFIP UNDERMINES CONGRESSIONAL PRINCIPLES

1. Old Flood Maps Create New and Hidden Subsidies and Endanger Homeowners

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 three to five 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 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.[1] 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 built to FEMA's standard just prior to the hurricane was building about 10 feet below the real 100-year risk. The flooding that occurred in many areas after the hurricane was truly a disaster waiting to happen because of FEMA's incompetence.

Consider map MS-G8.[2] Here, a person complying with FEMA's 100-year map just before the hurricane hit would have been required to elevate 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.

2. Costs in The Write Your Own Program are Excessive

In recent years, CFA has consistently asked why private insurers cannot assume a greater role in writing flood insurance. Insurers originally objected to a private role when the National Academy of Sciences (NAS) conducted a feasibility study because they said they could not price

[1] 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.
[2] 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.

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 consider a long-term program to shift flood insurance back into the private sector, where political pressures to bring rates below the actuarial level for people who can afford higher costs will not be present. CFA will remain committed to ensuring that lower and moderate-income residents have access to affordable flood insurance.

However, if the program is to remain a fully federal one, then why continue the Write Your Own Program (WYO)? It is terribly expensive and has not significantly increased the market penetration of flood insurance as insurers said it would. It results in wind/water claims adjustment conflicts-of-interest that could be avoided by using competitively bid contractors.

I raised this issue with you in testimony in 2005 and 2006. The GAO has just issued a report that shows that FEMA has no idea if expenses for the WYO program are anywhere near fair. Consider this information from the GAO[3]:

Fiscal Year	Premium Revenue	Payments to WYO Companies	% of Premium Paid to WYO
2004	$1.8 billion	$ 619 million	34.9%
2005	$1.9	$ 985	50.7%
2006	$2.4	$1,584	64.9%

In "good" years, the WYO program takes over one-third of the NFIP premium, a remarkable sum. In years with claims, the very time the program needs resources, the WYO takes increases. In the wake of Hurricane Katrina the share of the program paid to WYO insurers was almost two-thirds of the premium. In 2000, it was 37% of premiums, almost three times the losses paid in that year.

As the Insurance Transparency Project put it, when they reviewed the GAO report on expenses, "Now that's what ITP calls 'Write Your Own' all right. Wow."[4]

The costs of the WYO program are too high. The use of contractors should be expanded and 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.

[3] Government Accountability Office, National Flood Insurance Program, FEMA's Management and Oversight of Payments for Insurance Company Services Should be Improved, September 2007.
[4] *Insurance Notes!*, "GAO: Private Insurers Take 1/3 of Flood Premiums for Sales Commissions, Expenses, Starkman, Insurance Transparency Project," September 20, 2007.

3. The Write Your Own Program is Ineffective and Rife with Conflicts-of-Interest

Is the extraordinarily high cost of the WYO program producing excellence in result? The evidence indicates that this is not the case. There are two measures of success in flood insurance servicing: good market penetration and a high level of policyholder satisfaction after a claim.

Market penetration is weak. When I left the program in 1980, there were 2.3 million policies in force. The WYO program began in 1983. In 1993, after 10 years of the program, there were 2.5 million policies in force. Only after Hurricane Andrew showed the ineffectiveness of the WYO effort did policies increase, thanks to a sharp increase in NFIP advertising by FEMA. Even today, at about 5.5 million policies, the percentage of the flood-prone properties covered by flood insurance is only about 30 percent, according to our estimates.

The handling of claims by WYO insurers is very poor and marked by severe conflicts-of-interest. 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 the NFIP.

Lawsuits abound. In *Norman and Genevieve Broussard v. State Farm Fire & Casualty Company*, a federal judge and jury in Gulfport found that State Farm engaged in illegal cost shifting that was likely adverse to the NFIP. A federal judge and jury in *Robert and Merryl Weiss v. Allstate Insurance Co.* came to the same conclusion about Allstate. Eight whistleblowers from a third-party adjusting firm allege that a unit of American National Property & Casualty Insurance Co. assigned $95,000 in flood damage to property that never flooded at all.[5] Some public adjusters are saying that insurers are charging the flood program 300 percent more for sheetrock and other materials than they would charge themselves for the same house, depending on whether wind or water caused the damage.[6]

Consider these additional examples of claims abuses that likely adversely impact the NFIP, which are posted on the website of Representative Gene Taylor of Mississippi.[7]

1. "Emails exchanged by engineers revealing that State Farm fired their firm because two assessments ruled that damage was caused by wind. The emails reveal that State Farm demanded that reports name only the "predominant" cause of damage rather than estimate what damage was caused by wind and what damage was caused by flooding, and that State Farm instructed the firm to identify all water damage as flood damage. FAEC agreed to reassess the reports in order to keep the State Farm business."

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5 "Whistleblower Suit Accuses Insurers of Overbilling Federal Government," *Times Picayune*, May 30, 2007.
6 "Same House, Same Repairs, Same Insurer: Why Different Prices?", Times Picayune, May 20, 2007.
7 http://www.house.gov/genetaylor/OIHearing.Docs.htm.

2. "Affidavit by Cori Rigsby & Kerri Rigsby in *McFarland v. State Farm*, in which the Rigsby sisters described the actions of State Farm officials to manipulate Katrina claims in Mississippi."

3. Engineering reports in cases known as *McIntosh, Mullin, Nguyen, Beckham, Gaspard, Kuntzman* and others showing engineering reports citing wind damage being scrapped, and others citing water damage shown to homeowners.

4. "Oct. 12, 2005 report of on-site damage assessment conducted by engineer Brian Ford of FAEC for State Farm. Ford concluded that damage to the McIntosh home was caused by wind, wind-driven debris, and "failure of the windows, walls, and doors due to wind." Cori and Kerri Rigsby photocopied this report with a note attached that read, "Put in Wind file – DO NOT Pay Bill. DO NOT discuss. Second on-site damage assessment of the McIntosh claim, conducted by John B. Kelly of FAEC on Oct. 18, the day after FAEC agreed to State Farm's demand for a new assessment. Kelly's assessment, which did not mention the previous assessment by Ford, concluded that "damage to the first floor walls and floors appears to be predominantly caused by rising water from the storm surge and waves."

5. "Emails exchanged by engineers revealing that State Farm fired their firm because two assessments ruled that damage was caused by wind. The emails reveal that State Farm demanded that reports name only the "predominant" cause of damage rather than estimate what damage was caused by wind and what damage was caused by flooding, and that State Farm instructed the firm to identify all water damage as flood damage. FAEC agreed to reassess the reports in order to keep the State Farm business."

The most significant evidence that WYO insurers are more worried about their own interests than that of the taxpayers is that many WYO carriers have adopted anti-concurrent causation clauses (ACCs) in homeowners' policies. This blatantly anti-consumer clause works like this: If an insured wind claim is filed that occurred at about the same time as a flood claim, the wind coverage is voided and the insurer pays nothing for wind (but will pay the flood claim on behalf of the NFIP). Insurers claim the legal right to revoke wind coverage because flood damage occurred, even for distinguishable flood damage occurring hours after the wind damage happened.

The use of the ACC clause by WYO insurers exposes taxpayers to huge potential liabilities not anticipated in the calculation of flood rates by making it more likely the NFIP will end up paying for at least some wind damage.

CFA calls on Congress to require that as a condition of being a WYO company, any company seeking to become or remain as a WYO agrees not to use private policies with an ACC in conjunction with NFIP policies it administers. Such a requirement passed the House last week as part of their flood insurance legislation, H.R. 3121.

To the extent that insurers underpay wind losses when allocating damage between their homeowners' policies and NFIP policies, 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.

In its recent preliminary report on this subject, GAO found that FEMA "does not have all the information it needs to ensure that its claims payments were limited to damage caused by flooding."[8] GAO expressed concern about a "potential conflict of interest."

GAO pointed out that the NFIP does not collect any information on wind damage, limiting the usefulness of FEMA's claim reinspection program. In other words, GAO says that FEMA does not know if flood claims are being properly paid or if the taxpayer is paying for wind damage that should have been paid out of the WYO insurer's pocket.

To make matters even worse, FEMA relies on Computer Sciences Corporation (CSC) as its contractor to help run the NFIP. In this role, CSC works for the government in managing the program. However, CSC has very large contractual arrangements with many of the WYO insurers in providing them software programs that run significant aspects of their businesses. We would like to see GAO also undertake a review of these potential CSC conflicts-of-interest.

C. RESTORING THE NFIP TO LONG-TERM SOLVENCY

The damage caused by Hurricane Katrina and other recent storms in the past three years, with payouts over $20 billion, has raised the question of the best way to make sure the program serves homeowners who need it, but minimizes taxpayer exposure as Congress wanted when the NFIP was first enacted. 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 eliminated from the program by age and damage. However, many subsidized structures are still in the program.

The subsidy built into the NFIP was there for a reason that made sense at the start of the program, but decades later makes far less sense. The NFIP subsidy was never intended to help poor people obtain insurance, although it probably did so for a subset of the population. The subsidy was intended to help people – rich as well as poor – who had built before the Flood Insurance Rate Maps (FIRMs) were in place who might not have realized that there was a flood risk, or who misunderstood the degree of such risk. The subsidy was also an incentive for the communities to join the program and thereby put mitigation (land use) requirements in place.

Over 30 years – a generation – has passed since the original FIRMs have been in place. In retrospect, the program should have phased the subsidy out as homes were sold, since the maps would have been available at that point. In other words, reducing the subsidy at each sale would have been both equitable and financially wise. Congress should start this process now so that thirty years from now taxpayers will not be continuing to subsidize most pre-FIRM structures.

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[8] Government Accountability Office, National Flood Insurance Program Preliminary Views on FEMA's Ability to Ensure Accurate Payments on Hurricane-Damaged Properties, June 2007.

Such a phase-out of subsidies should definitely take into consideration the ability to pay of the homeowners of pre-FIRM properties. Subsidies for low value structures should be phased out more slowly, or some other method should be used to assure that removal of the subsidies do not make insurance unavailable for the poor living in a pre-FIRM home.

The recent Congressional Budget Office report[9] offers very important insights into the structures being insured under the NFIP and the subsidy structure of the program. Here are some of the more interesting findings:

- Properties insured by the NFIP tend to be more valuable than other properties nationwide. The most valuable structures are in coastal areas.
- Many subsidized properties have high values.
- Subsidized properties in coastal areas are less valuable than unsubsidized structures.
- In the sample, 23 percent of the coastal properties are not the policyholders' principle residences.

Thus, it is clear that many enjoying subsidies today do not need continued taxpayer largesse.

The time has come to find ways to lower the subsidy over a relatively short period of time. 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 beyond the primary residence for an insured homeowner 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 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.

- Subsidies should be eliminated on all structures that have experienced more than one flood with over $5,000 in program losses in the past.

- As stated above, Congress should explore shifting flood insurance coverage back into the private sector over time.

[9] Congressional Budget Office, Value of Properties in the National Flood Insurance Program, June 2007.

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.

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. Non-federal lenders, such as state banks and life insurance companies, should be required to require flood cover on high-risk homes.

It is evident that many structures are being built in high-risk areas of the nation, such as on barrier islands. There should 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 (FIRMs) were put in place in participating communities to see how the development conforms to the requirements of the FIRMs. 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 in 2004, should be a significant help in controlling costs and must, at long last, be adopted by FEMA.

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.

D. COMMENTS ON PROPOSALS FOR REFORM

1. H.R. 3121

Attached to this testimony is a letter of opposition to H.R. 3121 that CFA distributed last week.

Our key concern with the bill is that this legislation would significantly expand the NFIP and increase costs to taxpayers, while taking inadequate steps to overhaul the wholesale mismanagement of the program or to reduce unwise construction in flood plains that has occurred despite instructions from Congress to make the program actuarially sound. It would add wind coverage, increase limits on flood coverage, add business interruption coverage, add additional living expense coverage, and effectively lower the elevations of existing structures by allowing coverage below current first floor elevations. It would not require that a mitigation program be in place when wind coverage became available. In fact, given the permissive language of the bill, such a program might never be put in place.

The bill would reduce subsidies, but only by phasing in reductions starting in 2011—four years from now. This is far too little and far too late.

2. S. 3589 of the 109th Congress

In the last session of Congress, this Committee reported to the Senate Floor legislation to restructure the NFIP (S. 3589) in a much more effective manner than the House effort. S. 3589 took several positive steps, including:

- Focusing on the critical need to reduce subsidies now;
- Requiring that state-charted banks require flood insurance to increase market penetration;
- Adding reasonable deductibles to the program, reducing taxpayer exposure;
- Building reserves, over time, for future large losses;
- Adding a 500-year floodplain to the maps as well as require that the flood risk behind dams and levees be evaluated;
- Studying the excessive expenses paid to WYO insurers; and
- Studying the impact of expanding coverage rather than expanding them at a time of program insolvency.

CFA believes that this bill is a good place for you to start your consideration of how to improve the NFIP. We believe that removing more of the subsidy as we outlined earlier in this testimony could strengthen the bill. We particularly would like to see more emphasis on mitigation efforts, which we believe has not been strong under FEMA's recent administration of the program. It does no one – rich or poor – any favor to allow unwise construction in areas of special flood hazard. As demonstrated above, the program's promise of reducing loss of life and property through strong mitigation efforts has been undermined in recent years.

E. 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 program. However, repeal of the NFIP should be considered 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 flood plains, and taking steps to achieve full actuarial soundness. Congress must undertake tight oversight of FEMA's implementation of the program to achieve these vital goals. We do not trust FEMA to do it without such pressure being brought to bear.

Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

September 27, 2007

Re: Urge Opposition to Costly and Harmful Flood Insurance Expansion, H.R. 3121

Dear Representative:

The Consumer Federation of America urges you to oppose H.R. 3121, the Flood Insurance Reform and Modernization Act of 2007, which the House will vote on today. **This legislation would significantly expand the National Flood Insurance Program – and increase costs to taxpayers – while taking inadequate steps to correct the wholesale mismanagement of the program or to reduce unwise construction in flood plains that has occurred despite instructions from Congress to make the program actuarially sound.** Ultimately, this will harm home and business owners, who may – once again – be encouraged to build or buy in coastal areas prone to flooding.

This is unfortunate, because the NFIP was brilliantly conceived. Taxpayers would subsidize existing construction but new construction would not be allowed to occur in the highest-risk areas, such as high velocity "V" zones. In lower risk areas that would still experience serious wind damage and flooding, all new construction would have to be elevated according to local building codes.

However, poor management by the Federal Emergency Management Agency (FEMA) and lax enforcement of building requirements by local governments has made the program insolvent. Flood maps that FEMA was originally supposed to update every three years are antiquated. Some are over 20 years old. As a result, flood levels that were predicted before Hurricane Katrina were more than ten feet too low in areas like Hancock County, Mississippi. Moreover, the areas of predicted high-risk were much too small. Many who appeared to be "outside" the flood plain were actually in it and should have been required to buy flood insurance coverage. Since rates and mitigation requirements are based on these maps, taxpayers are subsidizing unwise construction as a result.

Unfortunately, H.R. 3121 would actually expand the NFIP in several significant ways without taking the bold steps that are necessary to bring the NFIP into fiscal alignment and discourage reckless building:

- **Maximum flood coverage would be expanded from $250,000 to $335,000 for homes and from $500,000 to $670,000 for businesses.** The program would also increase limits on contents coverage and cover additional living expenses and business interruption costs for the first time. Remarkably, the bill would offer coverage for the first time for losses in basement or lower-home areas, the highest risk parts of homes, effectively lowering the elevation of all homes in the current flood plains.

- **Wind losses would be covered for the first time** (at non-subsidized rates.) Requiring FEMA -- one of the most incompetent federal agencies in recent history -- to supervise the adjustment of both flood and wind claims could be a recipe for disaster for many homeowners and taxpayers. H.R. 3121 requires wind policies to be underwritten starting in June, 2008 but places no requirements on FEMA or localities to reduce possible wind damage on homes that the government would insure. Instead of mitigation requirements, the bill requires a study. If and when FEMA ever gets the study, it is authorized (but not required) to "encourage" state and local measures that will reduce wind damage. This is a clear opportunity for developers to build unsafe structures while FEMA waits for the study, tries to develop a mitigation plan, attempts to convince communities to adopt the plan and actually enforces it. Even if they had a plan, FEMA would likely mismanage it, as it has with flood mitigation.

- **Unjustified subsidies are allowed to persist**. The bill phases in over an unidentified period of time a reduction in taxpayer subsidies for second homes and commercial structures, but this process does not begin until 2011. There is no justifiable reason to wait such a long period of time to begin eliminating subsidies for more affluent homeowners who can afford second homes. The bill also requires only a study of whether subsidies could be reduced for "pre-FIRM" homes (built prior to the availability of the Flood Insurance Rate Maps) rather than requiring that non-subsidized rates are charged on more expensive pre-FIRM homes.

- **Meaningful steps are not taken to improve the penetration of flood insurance**. Over 2 million homes were insured by the NFIP in the 1970s. Today there are only 5.4 million insured homes, despite requirements that federally supervised lenders require the purchase of insurance by borrowers in flood plains. Something is clearly wrong with the way the some lenders track the purchase of flood insurance by their borrowers. In response, this bill merely requires a study of whether state-regulated insurers should mandate the purchase of flood insurance.

- **A 500-year mitigation and purchase requirement (rather than the current 100-year standard) is studied but not required**. A 500-year standard would mean no taxpayer subsidies in the areas that have experienced storms between 100-year and 500-year storm levels.

CFA does support the amendment to H.R. 3121 to be offered by Representative Gene Taylor that would eliminate a conflict-of-interest that encourages insurers to refuse to pay legitimate wind claims and to shift the cost of these claims to the NFIP. This amendment would prohibit private write-your-own (WYO) insurers that offer flood insurance from using anti-concurrent causation (ACC) clauses in wind coverage. ACC clauses negate wind coverage for homeowners if flood damage occurs during the same general period of time. If insurers were prohibited from using ACC clauses, they would have to fully adjust each wind loss to determine how much of the damage was caused by wind and pay for that damage, subject to audit by the federal government.

Rather than expanding a program in disarray, we urge Congress to repair the fiscal soundness of the NFIP and to prove to taxpayers it can actually end subsidies of unwise construction.

Sincerely,

Travis B. Plunkett
Legislative Director

J. Robert Hunter
Director of Insurance

TESTIMONY OF MARK DAVEY

BEFORE

SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

CONCERNING

THE NATIONAL FLOOD INSURANCE PROGRAM

ON BEHALF OF

FIDELITY NATIONAL PROPERTY AND CASUALTY INSURANCE GROUP

My name is Mark Davey and I am President and CEO of Fidelity National Property and Casualty Insurance Group. The Fidelity National Property and Casualty Group consists of the P & C Companies; Fidelity National Insurance Company (FNIC), Fidelity National Property and Casualty Insurance Company (FNPAC) and Fidelity National Indemnity Insurance Company (FNII). Through these three companies policies are underwritten in all 50 states for flood, personal lines and niche commercial programs.

Fidelity is currently the largest provider of flood insurance through the NFIP. We service this business through a large flood processing center located in St. Petersburg, Florida. A staff of approximately 185 flood specialists is exclusively dedicated to supporting the NFIP Flood product line. In addition Fidelity has 28 full time sales associates focused exclusively on flood insurance.

Fidelity's Flood insurance is sold by approximately 15,000 independent agents and brokers throughout the United States. Fidelity's 2006 written premium of $398 million represents approximately 15% of the NFIP program. Fidelity is on track to produce in excess of $430 million for calendar year 2007. We are confident this makes us the largest provider of the National Flood Insurance Program's policies in the country. Fidelity is one of 88 property and casualty insurance companies marketing and administering policies on behalf of the NFIP.

Fidelity has established an excellent reputation for policy and claims service. Since entering the property and casualty business in 2001 and becoming a representative carrier for the National Flood Insurance Program in 2003 it has received the NFIP's Administrator's Quill Award, in recognition for excellence in service and marketing three times. We have complied with all audit requirements through either Biennial audits or KPMG audits sponsored by FEMA. Fidelity takes great pride in providing the most innovative policy quoting and issuance platforms in the industry. Fidelity constantly strives to expand its product lines and enhance our customers' experience.

How the NFIP Works

Fidelity and other carriers who market and service on behalf of the NFIP fulfill all obligations of a traditional insurance company with one major exception, that being the insurance companies do not assume the policyholder risk. The actual risk is 100% underwritten by the Federal Government through the National Flood Insurance Program. Insurance companies are responsible for all marketing, policy quotation, sale, issuance and servicing, in addition to all claims handling and claims payment. Currently Fidelity and all the other participating companies receive an expense reimbursement of 30.2 percent for the policy issuance, servicing and marketing. Fidelity and other NFIP representing companies also receive a 3.3% claims administration fee when claims are adjusted and paid. The 30.2% processing fee is used to pay independent agency commissions, processing costs, marketing costs, and state premium taxes.

While the insurance industry has reduced their underwriting costs for traditional lines through automation and better processing techniques, flood insurance has become more cumbersome to rate and process. Marketing, administering and interfacing with the NFIP is a truly specialized field. The rating process requires actual location information such as flood zone, determining elevation, reviewing pictures, and numerous forms to determine the correct rate for the property. This process does not lend itself to high automation. Flood insurance is a very complex product. The longtime viability of any line of insurance is achieved through spread of risk, and flood is no different. The vast majority of flood insurance policies are written in mandatory flood zones. Despite our experience in the wake of Katrina, few people ever believe they will experience a flood. And if they do flood, they don't think it will happen again; as a result, maintaining a spread of risk is very difficult.

Proposed Reforms to the NFIP

While Katrina was an anomaly during the life of the flood program, we must be proactive in reforming the program to ensure its long term viability. Our recommended changes include:

1. Funding must remain intact for FEMA's Map Modernization program. There were far too many years when funding was not available that maps were not updated. It has been a monumental task for the Map Modernization to be where they are now in the process. This process must continue and must be ongoing as the floodplain changes; the flood maps must also be updated.
2. Tracking must improve to ensure properties in high risk zones are covered for the life of the loan and not just at loan origination. Far too often policyholders are allowed to let their coverage lapse.
3. Provide for the reauthorization of the program for ten years. Shorter reauthorizations jeopardize the programs efficiency and have caused major disruption in the market place as recently as 2003 when the program was allowed to lapse.
4. The program should expand the mandatory purchase requirement to include additional properties at risk. Properties that are located behind a levee or other protective barrier, or are located near the coast of a major body of water are often in serious danger of flooding. Mandatory purchase requirements should not be limited only to those located in Special Flood Hazard Flood areas.
5. In order to reduce litigation, which significantly raises operational costs for all stakeholders, the federal NFIP statute must affirm federal court jurisdiction over all disputes relating to procurement of a policy and adjustment of claims under this program.
6. The program should increase the maximum coverage limits above the current available limits. The option to insure all buildings to their replacement cost value should be included.
7. Review and amend the Unallocated Loss Adjustment Expense to achieve adequacy for the program and the Write Your Own companies in both catastrophic and non-catastrophic years.
8. Revise and rewrite the Standard Flood Insurance Policy to make it more consistent with standard homeowners and other property/casualty insurance products.
9. Policy rating should be simpler and less cumbersome so that the risk can be rated accurately and quickly.
10. Disaster assistance procedures should be changed to ensure that those with flood insurance are paid ahead of those who have not purchased flood insurance.
11. Lenders should be required to establish escrows for policies outside the Special Flood Hazard Areas.
12. Provide additional educational materials and strengthen requirements for flood protection.
13. Maintain oversight of Write Your Own companies through biennial audits.

Expense Reimbursements and the GAO Report

One of the reforms that was discussed in last year's reform efforts is a significant reduction in expense reimbursements. That discussion is likely to be renewed in the wake of the GAO study released last month entitled, "FEMA's Management and Oversight of Payments for Insurance Company Services Should be Improved." I believe that the study seriously misrepresents the expense reimbursement issue and I feel compelled to address those misrepresentations.

It was quite disconcerting to review the GAO study and see a chapter heading that said, "Payments to WYO Insurance Companies Comprised Up to Almost Two-Thirds of Total Premium Revenue in Recent Years Based on Payment Methodologies Established in 1983". This has led to criticism of the WYO companies amidst claims that we are receiving in excess of 60% commissions on the policies we sell. That is simply not the case. The claims administration fees and adjusting fees cannot be disregarded when examining this period. As the GAO's report states, prior to the unprecedented and incomprehensible events of 2005 the National Flood Insurance Program was self-sustaining. Relatively speaking, I would argue that the program prior to 2005 was efficiently fulfilling its mandated cause in a fiscally responsible manner. The early drafters of this program should be commended for creating a program in 1968 which has performed as designed with little modification for almost 40 years. The science of statistics is one of our most powerful analytical tools available today. However, when statistics are quoted and utilized out of context their destructive incorrect inferences can cause substantial damage. The utilization of the individual data components to validate the above referenced statement is factual, but when taken out of context it is extremely misleading. Katrina not only highlighted the need to examine specific components of the NFIP, it also forced policy makers, businesses and individuals to rethink an extremely broad range of practices and policies. Relating to the NFIP claims funding and administration process, we need to analyze the basic funding mechanisms and administration models to properly and adequately respond to future events of Katrina's magnitude.

I am troubled by the tone and inferences made in some sections of the report. We followed set protocols to the letter. When granted additional flexibility to expedite our process, we declined in most instances. We were compelled to adhere to our standard diligent claims process and individually examine each and every claim on its own merits. To the best of my knowledge, every dollar paid for flood damage went towards actual documented flood damage. We were good fiduciaries of the Federal Government's monies. We should not be faulted for following protocol as set forth by regulation and for receiving the commensurate fees as provided by the same regulations. Based on recent events should the claims administration fees structure be reviewed? Yes. We stand ready and willing to participate in any review and redrafting process to make the NFIP a better program for non-cat times and truly catastrophic times.

We know the policy administration expense reimbursement provisions are being re-evaluated. We believe the present mechanisms in place perform very well. Efficiency in one's operations are rewarded, while inefficiencies are unsustainable. The economics for the production and administration facets of the NFIP are fair and not excessive. The current plan properly motivates companies to increase the penetration of the NFIP product sale in flood prone areas. The expense reimbursement mechanisms are in line with their respective expenses incurred by the Write Your Own carrier. We stand ready to review our carriers' actual expenses with FEMA and other interested parties. We can clearly demonstrate that they are not excessive. I believe our organization is one of the most efficient WYO companies.

We have complied with the required bi-annual audit requirement. We feel it is essential that all companies immediately take the necessary actions to be compliant with specified existing requirements. The NFIP must create the necessary infrastructure to review all information obtained through the audit process and take immediate action as warranted.

It is worth noting that 95% of Katrina and Rita claims were settled by May of 2006, about 9 months after the storm. I cannot speak for other carriers, but in regards to our NFIP policyholders, we believe we qualified and paid our policyholders NFIP claims per the prescribed guidelines fairly and professionally. I know we had one of the largest claims loads of all WYO carriers and I am proud of the response we provided to our customers. We did everything possible to make certain we assisted our customers while strictly adhering to the NFIP's prescribed claims handling processes and policy provisions. We take our fiscal responsibility to the Federal Government very seriously.

Thank you, acting chairman Carper, ranking member Shelby and members of the Senate Banking Committee for the opportunity to appear before you today on behalf of Fidelity National and present our views on the National Flood Insurance Program and how this federal program should be improved.

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STATEMENT OF VINCE MALTA ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS®

Before the

The Senate Committee on Banking, Housing and Urban Affairs

"AN EXAMINATION OF THE NATIONAL FLOOD INSURANCE PROGRAM"

October 2, 2007

Introduction

Thank you, Chairman Dodd for inviting me to testify today before the Committee on Banking, Housing and Urban Affairs and present the views of the National Association of REALTORS® (NAR) on the National Flood Insurance Program.

My name is Vince Malta. I am the owner and broker of Malta & Co., Inc, a San Francisco California firm handling real property sales and management of over 300 residential rental units. I am a member of the California Association of REALTORS® and National Association of REALTORS® and have held a number of leadership positions in both associations, including serving as the 2006 President of the California Association of REALTORS® and the 2007 Vice-Chair of the Public Policy Coordinating Committee for the National Association of REALTORS®.

The National Association of REALTORS® is America's largest trade association, representing more than 1.3 million members involved in all aspects of the residential and commercial real estate industries. NAR is the leading advocate for homeownership, affordable housing and private property rights.

Overview

The National Flood Insurance Program (NFIP) has been effective in reducing the costs of flood damage both to property owners and the government. A recent study of the NFIP, found that the program "has clearly induced savings on flood costs" and that "flood insurance has shifted the loss from taxpayers to those who pay the insurance premium."[1] According to FEMA,

[1] Pacific Institute for Research, "Costs and Consequences of Flooding and the Impact of the National Flood Insurance Program," (prepared as part of the 2001-2006 Evaluation of the National Flood Insurance Program), (Calverton, MD: October 2006), p. 28 (hereafter, "PIR Study").

flood damage is reduced by nearly $1 billion a year as the result of communities implementing sound floodplain management requirements and property owners purchasing flood insurance.[2]

Although the NFIP has been effective at reducing costs to property owners and the federal government, flood damage during 2004 and 2005 has shown the need for reforming the program to better protect more people at risk and to put the program on a stronger financial footing.

Legislation to reform the NFIP should: 1) ensure that flood maps are accurate and up to date; 2) address the NFIP's ability to pay existing and future obligations to policyholders; and 3) educate consumers about the importance of obtaining and maintaining flood insurance, which could in turn lead to increased participation in the NFIP. Though supportive of reforms to the NFIP, REALTORS® are concerned that some proposals could have undesired impacts on certain segments of the population, neighborhoods and communities. NAR encourages Congress to strike a balance between ensuring the long-term fiscal viability of the NFIP and avoiding changes that may result in market inequities and housing affordability problems, especially for low- and moderate-income homeowners and renters.

The National Association of REALTORS® encourages the committee, as it develops legislation to reform the NFIP to consider the findings of a report released in October 2006 that found "[t]he common belief that the NFIP has stimulated development that increased flood losses is not supported by our findings."[3]

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[2] See: http://www.fema.gov/about/programs/nfip/index.shtm.

[3] PIR Study, p. 41. The study also notes that the subsidy may prevent some properties, especially those located below base flood elevation (BFE), from being replaced or substantially renovated, which would lead to a removal of the subsidy on these properties. As noted below on pages 7-8, NAR supports adding demolition and rebuilding as a mitigation measure, which would have the effect of removing the subsidy on these properties.

The Importance of the National Flood Insurance Program

A strong real estate market is the linchpin of a healthy economy, generating jobs, wages, tax revenues and a demand for goods and services. In order to maintain a strong economy, the vitality of residential and commercial real estate markets must be safeguarded.

The National Flood Insurance Program is a unique partnership among property owners, all levels of government, and the private sector. 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. More than 20,000 communities throughout the United States and its territories participate in the NFIP and have adopted floodplain management ordinances. In each of these communities, the NFIP makes federally-backed flood insurance available to homeowners, renters, and business owners. As a result of these proactive efforts, federal expenditures for disaster assistance and flood control are reduced.

Since its creation, the National Flood Insurance Program has helped to mitigate the escalating costs of repairing damage to buildings and their contents caused by floods. Buildings constructed in compliance with NFIP building standards suffer approximately 80 percent less damage annually than those not built in compliance. According to FEMA, flood damage is reduced by nearly $1 billion a year as the result of communities implementing sound floodplain management requirements and property owners purchasing flood insurance.

As of August 2006, the NFIP has paid more than $17.3 billion in claims for the 2005 floods.[4] This amount is greater than all claims paid out by the NFIP up to that point in time. In prior years, when losses exceeded the NFIP's ability to pay claims, the program was able to

[4] Government Accountability Office, "High-Risk Series: An Update," (January 2007), p. 91.

borrow money from the U.S. Treasury and pay it back with interest. The very sizeable flood losses resulting from the 2005 storm season have made people take a closer look at the NFIP.

Understandably, many members of Congress, after voting to increase the NFIP's borrowing authority three times, are seeking to reform the NFIP. The National Association of REALTORS® agrees that, given the importance of the NFIP to communities across the country, it is critical that the program be financially stable. Congress, FEMA, and industry stakeholders, working together, can make a number of changes to ensure that the NFIP rests on a solid footing well into the future.

Three Essential Elements of NFIP Reform Legislation

The National Association of REALTORS® encourages efforts to reform the NFIP that will: 1) ensure that flood maps are accurate and up to date; 2) address the NFIP's ability to pay existing and future obligations to policyholders; and 3) educate consumers about the importance of obtaining and maintaining flood insurance, which could in turn lead to increased participation in the NFIP. In addition, reform efforts should strike a balance between ensuring the long-term fiscal viability of the NFIP and avoiding changes that may result in market inequities and housing affordability problems, especially for low- and moderate-income homeowners and renters.

1. Accurate Flood Maps

As a necessary first step to providing flood insurance and implementing floodplain management regulations, the NFIP identifies and maps the nation's floodplains. This mapping process provides the data needed to design effective floodplain management programs, actuarially rate flood insurance policies, and create public awareness of which areas are subject to flood hazards. Accurate and up-to-date flood maps are the keystone to the NFIP.

The National Association of REALTORS® strongly supports FEMA's map modernization efforts. Without accurate maps, property owners are not able to properly evaluate the risk to their property from flooding. NAR has been, and will continue to be, a strong advocate of fully funding the map modernization program.

FEMA has been engaged in a map modernization program to update and digitize the flood maps for the 100-year floodplain for several years. According to a report by the General Accounting Office submitted to the Chair of the House Subcommittee on Housing and Community Opportunity in March 2004, when Congress appropriated funds in FY 2003 to allow FEMA to undertake a full-scale update of the nation's flood maps, FEMA expected the effort to take five years to complete.[5]

NAR is concerned, however, that a requirement to map the 500-year floodplain – a task much larger than updating the existing 100-year floodplain maps – as part of FEMA's map modernization program could lead to delays in updating the 100-year floodplain maps, now scheduled to be completed in 2010. REALTORS® do not want to see this process delayed further. NAR believes that the ongoing efforts to update the 100-year floodplain maps should be completed before any effort to map the 500-year floodplain is undertaken.

On a separate, yet related issue, NAR supports reestablishing the Technical Mapping Advisory Council (TMAC) and strongly encourages the Committee to add a real estate professional to the TMAC membership. A real estate professional will be able to provide the perspectives of map users, including homeowners and potential homebuyers, and provide a user's perspective regarding how these maps impact real estate transactions.

2. Promoting Financial Stability

Reforms to the NFIP certainly will need to address the outstanding debt, increase revenues to the NFIP and decrease outlays. As a result of 2004 and 2005 flood damage, the NFIP owed the U.S. Treasury $17.5 billion as of May 2007.[6] As the Congressional Budget Office (CBO) has acknowledged, the NFIP "does not generate regular surpluses of the size needed to cover catastrophic losses."[7] CBO does acknowledge, however, that the NFIP "operated as a largely self-financed program for many years, occasionally borrowing relatively small amounts from the Treasury and repaying them."[8] There are a number of policy options to address NFIP financial stability that would have the support of REALTORS® and others where we would urge Congress to consider carefully.

Repetitive Loss Properties The National Association of REALTORS® supports policies and reforms that would limit the drain on the NFIP posed by severe repetitive loss properties. These properties, though a small percentage of properties covered by the NFIP, receive a disproportionate share of payouts from the program. NAR supports "full risk" premiums for flood insurance on repetitive loss structures that have repeatedly (i.e., more than two occurrences) suffered insured flood losses and have declined a reasonable offer of mitigation funding from FEMA, except in states which have been granted a federal exemption.

Repetitive loss properties pose a significant financial burden to the NFIP. Research conducted by the Multihazard Mitigation Council of the National Institute of Building Sciences

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[5] U.S. General Accounting Office, "Flood Map Modernization: Program Strategy Shows Promise, but Challenges Remain," GAO 04-417, March 2004, p. 8.
[6] General Accountability Office, "National Flood Insurance Program: FEMA's Management and Oversight of Payments for Insurance Company Services Should be Improved," GAO-07-1078, (Washington, D.C.: September 5, 2007), p. 10.
[7] Congressional Budget Office, "Value of Properties in the National Flood Insurance Program," (Washington, D.C.: June 2007), p. 1 (hereafter "CBO Report").
[8] Ibid.

found that a dollar spent on mitigation saves society an average of four dollars.[9] NAR supports amending the flood mitigation assistance program to allow "demolition and rebuilding" as a mitigation measure. In addition, NAR supports funding for mitigation activities for individual repetitive loss properties, and extending the pilot program for mitigation of severe repetitive loss properties.

Increased Participation Understandably, there is a desire to increase the money paid into the NFIP as a means of ensuring the financial solvency of the program. One way to help support the future stability of the NFIP is to increase participation in the NFIP by those properties most at risk of suffering flood damage. A 2005 study by the RAND Corporation showed that, in Special Flood Hazard Areas (SFHAs), those areas deemed by FEMA most likely to suffer flood losses and where flood insurance is mandatory for property owners with federally-backed mortgages, only about 50% of properties have flood insurance.[10] Increasing market penetration would lead to increased funds for the NFIP, would help protect property owners recover from flood losses, and could help decrease future federal assistance when uninsured properties flood and suffer loss.

According to a recent report on the NFIP, "knowledge of low-income issues is spotty."[11] Moreover, flooding from recent hurricanes in the Gulf Coast as well as in North Carolina has raised concerns that vulnerable low-income families have virtually no coverage.[12] Therefore, the National Association of REALTORS® encourages the committee to include a study in its NFIP reform bill that would identify ways to increase low-income family participation in the NFIP and identify ways to ensure that a greater percentage of at-risk homeowners and renters are able to

[9] Multihazard Mitigation Council, "Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities, Volume 1 – Findings, Conclusions and Recommendations," National Institute of Building Sciences, Washington, D.C. (2005), p.5.
[10] See PIR Study, p. 36.
[11] PIR Study, p. 43.
[12] Ibid.

protect themselves from future flood losses. We believe that any such study should include an analysis of how best to encourage renters to participate in the NFIP because they too are at risk and eligible to purchase content insurance.

Increased Coverage Limits Offering additional coverage to those already participating in the NFIP should also be encouraged. Increasing maximum coverage limits for residential properties, non-residential properties, and contents coverage would more accurately reflect increases in property and contents values and provide fuller coverage to policyholders. In addition, providing additional coverage for living expenses, basement improvements, business interruption and replacement cost of contents would help protect homeowners and business owners.

Mandatory Purchase Requirements Another option to increase revenues to the NFIP is to expand the mandatory purchase requirement to properties located behind levees and dams and in the 500-year floodplain. The National Association of REALTORS® encourages the committee to proceed cautiously when considering expanding the scope of the mandatory purchase requirement. NAR encourages the committee to include in its NFIP reform legislation a study to examine the effects of such an expansion on homeowners and renters.

Debt Coverage The outstanding debt owed to the Treasury by the NFIP also must be addressed. According to the CBO, the NFIP debt can be expected to grow by $900 million per year, given the current mix of policies.[13] In the 109th Congress, legislation passed by this committee would have forgiven the debt and created a long-term reserving mechanism to address future catastrophic losses on the scale experienced in 2005 and 2005. NAR encourages the committee to consider such an approach again in its NFIP reform bill.

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[13] CBO Report, p. 1.

Subsidy Elimination Eliminating subsidies in the NFIP is another idea that has been considered. The National Association of REALTORS® strongly encourages this committee to commission a study of the effects of phasing out subsidies on primary residences, non-primary residences and non-residential properties before including such a proposal in legislation. Properties built under the same circumstances and facing identical flooding risks should not be charged different premiums. While proponents of eliminating subsidies on non-primary residences and non-residential properties argue that such a change would make the NFIP more fiscally sound, there may be significant unintended consequences for renters, business owners, potential homebuyers, neighborhoods and local economies.

According to a CBO report on the NFIP released in June, "**the evidence here does not suggest that the subsidies tend to cover larger or more luxurious structures, whether inland or in a coastal area**."[14] [emphasis added] The same report also notes that coastal subsidized properties tend to be more valuable than coastal unsubsidized properties, but that the reverse is true for inland properties where unsubsidized properties are more valuable than subsidized properties.[15] Another study on the NFIP found that those in the middle-income brackets were less prone to live in higher flood hazard areas than either those in the highest or the lowest income brackets.[16] That study noted that "low income households [defined as $10,000 - $30,000/year] live in hazardous areas in order to find affordable housing or because they work in water recreation areas and find the least expensive housing nearby."[17]

The National Association of REALTORS® is concerned that eliminating subsidies would result in higher flood premiums, increase the cost of property ownership and rents in these areas, and could lead to increasing delinquencies, foreclosures and reduced property values. FEMA

[14] CBO Report, p. 7.
[15] CBO Report, p. 8.
[16] PIR Report, p. 43.

estimates that if the average subsidized policy were to pay its full-risk premium, that premium would be increased to $1,800 per year, or about two and a half times the current level; some properties could see premiums increase four-fold or more. There is a limit to the amount that insurance, or any other operating expense, can increase before owners are either forced to raise rents, sell their properties, or go without insurance. In the case of residential rental properties, it is especially likely that a significant portion of single-family property owners would be hard pressed to absorb such a cost increase without raising rents.

3. Educating Consumers

Educating consumers is essential to help protect against future loss from flooding. Many consumers may not be aware that flood insurance is available to them, especially if they live outside a high-risk flood area. The National Association of REALTORS® strongly encourages the committee to include education and information policies in its NFIP reform bill. As noted above, only about 50% of homeowners in high-risk flood areas purchase flood insurance. Unfortunately, floodwaters do not know or care which properties are insured.

REALTORS® play a role in educating consumers by increasing awareness of the NFIP and providing information on obtaining coverage. In addition, NAR has been working with FEMA to develop educational materials for REALTORS®, clients, and potential clients about the importance and availability of flood insurance through the National Flood Insurance Program. These materials should be finalized later this fall.

[17] Ibid.

Conclusion

Thank you again for inviting me to present the views of the National Association of REALTORS® on the National Flood Insurance Program. The National Association of REALTORS® stands ready to work with the members of the Committee on Banking, Housing and Urban Affairs to develop meaningful reforms to the National Flood Insurance Program that will help protect homeowners, prospective homeowners, renters, and commercial property owners prepare for and recover from future losses resulting from floods.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM ORICE WILLIAMS

Q.1. Since FEMA became part of the Department of Homeland Security, there have been concerns expressed about whether enough attention, staff and funds have been provided to flood mapping and natural disaster mitigation efforts. Has GAO looked at this resource allocation issue and its potential impacts on state and local governments?

A.1. Since 2003 when FEMA became part of the Department of Homeland Security, GAO has reviewed and reported on a variety of issues related to FEMA's flood mapping and natural disaster mitigation efforts, as well as agency-wide resource allocation issues and to a lesser extent, the extent to which these efforts could potentially impact state and local governments.

- For example, in March 2004, we reported that FEMA's implementation approach for the flood map modernization program was based on the assumption that partnerships with local, state and other federal agencies were needed to enable FEMA to leverage its resources and reduce the federal costs of map modernization.[1] We recommended that FEMA develop and implement strategies for partnering with state and local entities with varying levels of capabilities and resources and ensure that it has the staff capacity to effectively implement the nationwide mapping contract and the overall map modernization program.

  While FEMA had developed a strategy for partnering with these state and local entities to encourage greater involvement in map modernization, including the contribution of resources, we concluded that the overall effectiveness of the agency's partnering efforts was uncertain because FEMA had not yet developed a clear strategy for partnering with communities that have few resources, limited mapping capability, and little history of flood mapping activities. Regarding resources allocated to flood mapping, a FEMA staffing analysis determined that the agency needed an additional 75 staff with specific, identified skills to effectively monitor and manage the contract and overall map modernization program. As of January 2008, FEMA reported that 11 Flood Map Modernization Program individuals were certified in program management and FEMA had hired 30 of 43 authorized term positions to help oversee and manage the program.
- In January 2007, we reviewed FEMA agency-wide resource allocation efforts and reported that FEMA lacks adequate information on resources associated with its day-to-day operations.[2] For example, FEMA lacks adequate data on reallocations of resources among programs, projects, and activities, on staffing levels. We recommended that FEMA take steps to better manage resources for its day-to-day operations, including collecting data that enables managers to monitor progress and support

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

[2] GAO, *Budget Issues: FEMA Needs Adequate Data, Plans, and Systems to Effectively Manage Resources for Day-to-Day Operations*, GAO–07–139 (Washington, D.C.: Jan. 19, 2007).

resource priorities, using leading practices to develop a strategic workforce plan, and developing business continuity plans.

- In addition, in August 2007 we reviewed the collaborative efforts of federal agencies and other stakeholders to promote natural disaster mitigation efforts and reported that while FEMA, other federal agencies, and nonfederal stakeholders have collaborated on natural hazard mitigation, the current approach is fragmented and does not provide a comprehensive national strategic framework for mitigation.[3] We concluded that a comprehensive framework would help define common national goals, establish joint strategies, leverage resources, and assign responsibilities among stakeholders. Accordingly, we recommended that FEMA develop and maintain a national comprehensive strategic framework for mitigation. However, we did not evaluate FEMA's current resource allocations regarding mitigation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM DONALD L. GRIFFIN

Q1. In your testimony, you said that the NFIP should include revised and enhanced mitigation efforts to encourage strong, statewide minimum building codes that consider all the risks of loss due to natural disasters? I think this approach would help prevent flood and hurricane loss. Rhode Island has what is considered an advance program for coastal hazards to prevent damage before it can occur. The state's Coastal Resources Management Counsel has mapped the entire shoreline of the state and applies erosion setbacks to protect buffers. Does the private insurance market have a way to reduce premiums for homeowners and businesses in states that are taking initiative to reduce losses?

A.1. PCI believes that, yes, the approach I mentioned in our testimony would be beneficial with regard to both flood and hurricane loss. The Rhode Island program Senator Reed outlined would be beneficial in both of these areas as it would establish reasonable land-use policies that would prevent development of areas that are subject such catastrophic loss (as it is described). Accordingly, we strongly support such prudent state and local mitigation activities.

With regard to the second part of the question asking if the private insurance market has a way to reduce premiums for property policyholders in these situations, the answer is also—yes. The private insurance industry looks at various issues when developing its pricing for property exposures. These include fire protection, type and use of the structure, the building codes in the specific area, past losses in the area by type (*e.g.*, wind, fire, etc.), construction trends (labor and materials costs) as well as a variety of other factors. The less risk a property presents, the lower the overall cost of providing the insurance. Our industry, through one of its advisory organizations, Insurance Services Office, Inc. (ISO) developed the Public Protection Classification System that has, for decades, been the measure of fire protection for a community. It looks at

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[3] GAO, *Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework*, GAO–07–403 (Washington, D.C.: Aug. 22, 2007).

type of fire department, equipment, water flow, access to structures, training, etc. That organization has also recently developed the Building Code Effectiveness Grading Schedule which measures a community's building code program including the standards, training and experience of planning department staff, enforcement (which is vital), etc. Some private insurers are now starting to use this type of system as a way to evaluate and price property exposures and we expect market competition will encourage more to do so in the future.

Private insurers currently reduce premiums for mitigation activities as a result of loss experience and through individual company risk selection guidelines. These premium reductions are based on loss experience that accurately reflects the impact of a specific mitigation activity on insured losses. Pricing reductions that fail to have an actual impact on insured losses create distortions which result in inefficient and unfair pricing for risk spreading, the major social benefit of insurance. However, as it takes time for mitigation activities to show up in loss experience, and as their impact relative to other factors affecting insurance costs may be small; the reduced costs may not be as useful as we would hope in encouraging investment in mitigation by communities or individual property owners.

In regard to your comments on flood versus wind mitigation measures you may want to consider the following:

There is a growing recognition by experts and the public sector that significant benefits accrue from addressing mitigation from an all-hazards perspective. While some mitigation measures are specific to individual hazards (*e.g.* elevation above base flood requirements, sprinklers, safety programs) many address multiple hazards (*e.g.* disaster planning, safety inspections, etc.).

The synergistic effects of mitigation extend across hazards (e.g. disaster planning addresses fire, workplace violence, natural catastrophes, etc) and across risk bearers (e.g. the individual or property, the neighborhood, the community etc).

Where several individuals bear the cost of unmitigated losses stimulating mitigation investment decisions is facilitated by parsing out the costs of mitigation investments among all parties that pay the costs of losses. That is, mitigation decisions are facilitated when insurers provide incentives that match the extent to which they are affected; state, local and federal government contribute to mitigation relative to the burden they would bear if losses were to occur; and individual risk bearers contribute their pro-rata share.

In summary, we commend you for your state's efforts to reduce losses due to natural disasters and we believe that such programs are beneficial to all involved. PCI pledges to work with you on strong land-use and building code standards that will reduce loss of life and property for our citizens. Finally, we look forward to reauthorization and reform of the NFIP this year. Please let us know if you would like to discuss our response or have other questions with regard to our views on reforms to the NFIP.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Enterprise

October 16, 2007

The Honorable Christopher Dodd
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Dodd:

Thank you for introducing the Flood Insurance Reform Act of 2007. We strongly support your goal to expand flood insurance coverage and restore the financial solvency of the flood insurance fund.

Enterprise is one of the nation's leading providers of development capital and expertise for decent, affordable homes in thriving communities. For more than two decades, Enterprise has pioneered neighborhood solutions through private-public partnerships with financial institutions, governments, community organizations and other stakeholders. Enterprise has raised and invested $8 billion in equity, grants and loans and is currently investing in communities at a rate of a $1 billion a year.

Hurricanes Katrina, Rita and Wilma destroyed or caused major damage to more than 265,000 homes across the Gulf Coast region. Nearly half the families affected by the storms were very low-income and annually earned about $25,000 or less. The storms also laid bare longstanding conditions in the Gulf Coast that exacerbate the rebuilding challenges – high concentrations of poverty, overburdened local government agencies, overstretched and under resourced community-based organizations. Since the hurricanes, the ability to find affordable flood insurance coverage has exacerbated these already serious challenges.

We fully support amending the National Flood Insurance Program to provide additional coverage amounts to multi-family buildings. We very much appreciate the multi-family provision in the Flood Insurance Reform and Modernization Act to recategorize these properties as commercial in order to extend their reimbursement eligibility and further mitigate the loss potential for each transaction. We respectfully request that you expand this provision to allow apartment building owners to purchase flood insurance coverage up to the total number of dwelling units times the maximum coverage limit per residential unit, similar to the multi-family provision found in H.R.3121. Doing so would insure multi-family rental housing coverage is equal to that available to condominiums. As you know, currently Low Income Housing Tax Credit multi-family properties are eligible only for a $250,000 reimbursement per building under the federal flood program because, regardless of their size, they are classified as residential properties.

Enterprise commends you for your leadership on this issue and would welcome further discussions on how to enhance coverage for multi-family rental buildings. Please call upon us if we can provide additional information or assistance.

ENTERPRISE COMMUNITY PARTNERS, INC.
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Enterprise

Sincerely,

Ali Solis

Alazne M. Solis
Vice President of Public Policy
Enterprise Community Partners, Inc.

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