S. HRG. 112–229

# REAUTHORIZATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

## HEARING

BEFORE THE

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

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

ON

EXAMINING THE REAUTHORIZATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

JUNE 9 AND JUNE 23, 2011

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.fdsys.gov/

U.S. GOVERNMENT PRINTING OFFICE

71–669 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

TIM JOHNSON, South Dakota, *Chairman*

JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
ROBERT MENENDEZ, New Jersey
DANIEL K. AKAKA, Hawaii
SHERROD BROWN, Ohio
JON TESTER, Montana
HERB KOHL, Wisconsin
MARK R. WARNER, Virginia
JEFF MERKLEY, Oregon
MICHAEL F. BENNET, Colorado
KAY HAGAN, North Carolina

RICHARD C. SHELBY, Alabama
MIKE CRAPO, Idaho
BOB CORKER, Tennessee
JIM DEMINT, South Carolina
DAVID VITTER, Louisiana
MIKE JOHANNS, Nebraska
PATRICK J. TOOMEY, Pennsylvania
MARK KIRK, Illinois
JERRY MORAN, Kansas
ROGER F. WICKER, Mississippi

DWIGHT FETTIG, *Staff Director*
WILLIAM D. DUHNKE, *Republican Staff Director*

CHARLES YI, *Deputy Staff Director and Chief Counsel*
BETH COOPER, *Professional Staff Member*
LAURA SWANSON, *Policy Director*
BRETT HEWITT, *Legislative Assistant*

ANDREW OLMEM, *Republican Chief Counsel*
SHANNON HINES, *Republican Professional Staff Member*

DAWN RATLIFF, *Chief Clerk*
WILLIAM FIELDS, *Hearing Clerk*
LEVON BAGRAMIAN, *Hearing Clerk*
SHELVIN SIMMONS, *IT Director*
JIM CROWELL, *Editor*

# C O N T E N T S

## THURSDAY, JUNE 9, 2011



### WITNESSES



### Additional Material Supplied for the Record



## THURSDAY, JUNE 23, 2011



### WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

# REAUTHORIZATION OF THE NATIONAL FLOOD INSURANCE PROGRAM—PART I

**THURSDAY, JUNE 9, 2011**

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

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

**OPENING STATEMENT OF CHAIRMAN TIM JOHNSON**

Chairman JOHNSON. I would like to call this hearing to order. Today the Committee meets to examine the reauthorization of the National Flood Insurance Program.

Currently, constituents from my home State of South Dakota are dealing with some of the worst flooding that the State has ever seen. When I was back in South Dakota last week, I spent some time talking to homeowners and business owners in the communities that are anticipating some of the worst damage. While they are working hard to minimize harm to people and property, they are understandably concerned about short-term displacement and long-term recovery. I will do my best to see that they, along with our neighbors and fellow Americans who have had their lives turned upside down by devastating storms, are promptly provided with the disaster relief that they need.

I would also like to applaud Administrator Fugate and his staff at FEMA on how they have responded to the flooding in my State so far. I hope that the quick response that we saw during the recent sudden storms continues when addressing the ongoing flooding in South Dakota and around the country.

The NFIP was created to help communities limit damage and speed recovery from flooding disasters. However, it now faces several challenges to its long-term viability, including an $18 billion debt to the U.S. Treasury.

Over the past year, we have also faced several lapses in the NFIP. As many stakeholders have noted, lapses have detrimental effects on both the insurance and housing markets. This program, which provides over $1.2 trillion in coverage, needs certainty. It is my hope to provide this through a long-term extension.

As the people of South Dakota and others have seen firsthand, flooding is responsible for more damage and economic loss than any other type of natural disaster. It affects people across the Nation of both parties, which is why I believe that in 2008 the Senate was able to come together across the aisle and pass a bipartisan reauthorization bill by an overwhelming vote of 92–6. Unfortunately, in 2008, we were not able to come to an agreement with the House. The recent flooding has made it clear that Congress must reauthorize and reform the NFIP, which is set to expire this year on September 30.

As we move ahead, I hope we can once again come together and pass a bipartisan bill that will build a sustainable future for the program and American citizens.

I will now turn to Ranking Member Shelby, and then we will open it up to all Committee Members who wish to give an opening statement. Senator Shelby.

## STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

The National Flood Insurance Program was established in 1968 and was designed to reduce the burden on taxpayers stemming from Federal disaster relief for floods. By providing flood insurance for properties in high-risk areas, it was hoped then that insurance premiums could be used to cover the cost of flood damage. Since Hurricane Katrina, however, the program has struggled to remain financially viable. In fact, since early 2006, the GAO has targeted the Flood Insurance Program as "high risk because of its mounting debt and the structural flaws."

Today the program is nearly $18 billion in debt and has problems even servicing that debt. Unfortunately, as the GAO has shown, the program's debt is only one of many difficulties facing the Flood Insurance Program as it is constituted today. Every aspect of the program I believe must undergo significant revision for it to survive and to continue on a sustainable path.

During the 109th Congress, this Committee approved unanimously and the Senate overwhelmingly passed legislation that, while not perfect, addressed many of the core deficiencies of the program. That legislation would be a good starting point for this Committee as we move forward toward reauthorizing the National Flood Insurance Program. But as we begin this process, I believe several issues deserve a close examination by this Committee.

First, we should examine the relationship between the program and write-your-own insurance companies. According to GAO, write-your-own companies may be receiving excessively high reimbursements and bonuses from the program. The GAO recommended that the write-your-own program have more transparency and accountability. This is something we should pursue.

The Committee should also examine the types of properties the Flood Insurance Program is covering to ensure that its resources are spent effectively. For example, the Congressional Budget Office has determined that 12 percent of the homes covered under the program are worth more than $1 million. I believe we must ensure that the program requires wealthy participants to pay the full cost of their insurance.

The Committee should also examine the program's map modernization effort that we have been working on. The map modernization process has been ongoing for several years, and it is crucial for the long-term success of this program. Updated maps are important for two reasons: first, they warn developers and homeowners about the risk of developing or living in a floodplain; second, they ensure that participants are paying fair prices for flood coverage.

Some communities have called into question the validity of the maps, and others have argued that they have been excluded from the mapping process. Community participation I believe is crucial, but this process needs to take place rapidly to ensure that the risk is accurately reflected and homeowners and communities are fully informed.

Many of the existing maps are several decades old and do not accurately reflect the cost and risk of living within a floodplain. I think we should also see—I would like to see a simple definition of the phrase "actuarially sound" in any bill to reform the program. This simple act will clearly state our intent to make this program self-sustaining.

Finally, I believe this Committee should consider ways to privatize portions of this program. We should transfer risk from the program to the private sector to the maximum extent possible. If we are able to accomplish these objectives, we may finally achieve the original purpose of the Flood Insurance Program: to reduce the escalating cost of flooding to taxpayers.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Tester.

## STATEMENT OF SENATOR JON TESTER

Senator TESTER. Yes, thank you, Mr. Chairman. Thank you for holding this hearing on the reauthorization of the National Flood Insurance Program. It is a very, very important program. We need to get a long-term solution for this. Hopefully both sides of the aisle can work together to make that happen because this is very, very important.

I say that because the State of Montana is not exactly a flood State; it is a headwater State. It is underwater right now, and—I should back up. Good to have you here, Senator Wicker, and I appreciate your work on this issue. But the fact of the matter is we have seen record precipitation. We have record snowfalls still up in the mountains. I had talked to Craig Fugate yesterday at a hearing, and we will follow up on that conversation.

We have many, many challenges across this country when it comes to disasters, and water is one of them apparently this year.

So, with that, I want to thank you for having this hearing, and I look forward to the opportunity for questions and interchange between myself and Administrator Fugate. Thank you.

Chairman JOHNSON. I would now like to welcome Senator Roger Wicker from Mississippi, our Banking Committee colleague, to the Committee. Senator Wicker has switched seats temporarily to testify before the Committee.

Senator Wicker, welcome.

## STATEMENT OF ROGER F. WICKER, A SENATOR FROM THE STATE OF MISSISSIPPI

Senator WICKER. Well, thank you very much, Mr. Chairman and Mr. Ranking Member and Senator Tester. I have a written statement, which I will not read in its entirety and ask that it be included in the record at this point.

Chairman JOHNSON. Thank you.

Senator WICKER. I would also notice that the States of Montana and South Dakota have sent a great deal of water down our way this year, which we are experiencing right now. It only enforces the fact that we are all in this together and that we do need a multiyear reauthorization, and so I am here today to agree with Members of the Committee in that respect and to speak for a few moments about my proposal, which I am calling the COASTAL Act.

You were kind enough to allow me to testify last year before I became a Member of this Committee to sort of talk about the unique perspective we have and people in the State of Alabama and Louisiana and the Gulf Coast have with regard to flood insurance and the way it interplays with wind insurance. At that time I spoke about three reforms that I advocated:

Number one, improving enforcement by FEMA and lenders with respect to those required to purchase and maintain flood insurance. I do not think we do a good job there.

Number two, charging rates that are actuarially sound, as the Ranking Member just noted.

And, Number three, updating FEMA's flood insurance maps so that those in flood-prone areas are aware of the risk and obtain proper insurance coverage.

Mr. Chairman, it has been 6 years since Hurricane Katrina devastated the Gulf Coast. While we have made significant progress in rebuilding our communities and businesses, for many Mississippians recovery is still not complete. And one of the biggest impediments to our efforts is the lack of affordable property insurance. The availability and affordability of wind insurance is crucial in any State where there is a coastal exposure. For vast numbers of property owners, private insurance coverage for wind damage has not been available in the Gulf Coast since the aftermath of the 2005 hurricane season.

Hurricanes, as we all know, present a unique problem for coastal property owners because damages can be caused by multiple perils, including high winds and devastating storm surges. Currently homeowners cannot purchase a single policy that covers all hurricane-related damages. Wind losses are covered by private insurers or State-run wind pools, while covering for flood damage is largely backed by the Federal Government through NFIP.

As I have testified before, many property owners who suffered severe property damage from Hurricane Katrina were forced to go to court to determine which insurer was responsible for damage in wind *versus* water disputes.

Now, I want to also quote from the Government Accountability Office, which issued a report in 2007 which called for greater oversight of wind and flood damage determinations. In that report GAO found that claims information collected by NFIP did not allow FEMA to effectively oversee damage determinations and apportionments after hurricane events. These are the words not of Senator Roger Wicker but of the Government Accountability Office, and I quote:

"For a given property, FEMA's ability to assess the accuracy of payments for damage caused only by flooding is limited because NFIP does not know what portion of the total damages was caused by wind and what portion was caused by flooding."

The report goes on to say, "Because both homeowners and NFIP policies can be serviced with a single write-your-own private insurer, a conflict of interest exists during the adjustment process." The words, Mr. Chairman, of GAO.

Now, to help resolve these issues, I have recently introduced the Consumer Option for an Alternative System to Allocate Losses Act, the COASTAL Act. This legislation, S. 1091, which I invite each of you to cosponsor, addresses several problems that arose in the aftermath of Katrina. These problems include: Number one, disputes and costly litigation between consumers and insurers over the wind *versus* water claims; Number two, inherent conflicts of interest, as GAO pointed out; and, Number three, the lack of oversight with respect to the adjustment process and claims paid by NFIP.

I believe the COASTAL Act is a commonsense approach to addressing these problems. The legislation would use data currently collected by NOAA and other participating entities to allocate property damages following significant storms. Under the COASTAL Act, a formula would be established that utilizes storm information provided by NOAA and its partners, combined with structural information for each property, to allocate losses caused by high winds and storm surges from hurricanes. This alternative loss allocation system would be based on the timing, location, and magnitude of wind speeds and the storm surge before, during, and after a major storm impacts the coastline of the United States. Only properties completely destroyed by a hurricane would qualify under this loss allocation system. Slab cases, as they are commonly known, have the greatest uncertainty because there is little or no evidence left behind.

The COASTAL Act is by no means a silver bullet for all the problems associated with flood insurance and NFIP. However, it is a fair and objective way to provide more certainty to the slab claims process, which is a very costly piece of the greater Flood Insurance Program. The advantage of my proposal is that it is based on activities that NOAA already carries out. Extensive storm data related to wind and storm surges are currently collected throughout each named storm that threatens the coastline. This is done primarily now for the purpose of doing a better job of informing emergency managers. I would emphasize that the COASTAL Act does not create a new program. It, rather, uses information that we currently have for the purpose of better allocating the responsibility for wind *versus* water.

I believe this proposal will provide more structure in the marketplace, which should increase the availability of insurance and competition, thus driving down premiums over time.

I also believe this system will help us hold insurance companies accountable for covered losses rather than forcing taxpayers to foot more of the bill through the deeply indebted National Flood Insurance Program.

In conclusion, Mr. Chairman, I would say Congress has an opportunity to make wind and water coverage available and affordable while putting the National Flood Insurance Program on a sustainable path forward. I will continue working with each of you, my colleagues on the Committee, to pass a multiyear reauthorization bill that can be signed into law, and I urge all of my colleagues to join us in this effort.

Thank you.

Chairman JOHNSON. Thank you, Senator, for your testimony.

Now I would like to invite Craig Fugate, Administrator of the Federal Emergency Management Agency, to the table for his testimony. Prior to his May 2009 confirmation as FEMA Administrator, Mr. Fugate had a long career in emergency management at the State and local level, including serving as a volunteer fireman.

Welcome, Administrator Fugate. You may proceed with your testimony.

**STATEMENT OF W. CRAIG FUGATE, ADMINISTRATOR, FEDERAL EMERGENCY MANAGEMENT AGENCY**

Mr. FUGATE. Thank you, Chairman Johnson, Ranking Member, and Members of the Committee. I have submitted written testimony. If it please the Chairman, we will submit that for the record.

Chairman JOHNSON. It will be received.

Mr. FUGATE. I will proceed with a brief statement then.

I think Senator Shelby summed up really the structural issues we are faced with in the Flood Insurance Program, and I think one of the things that I would like to emphasize here is, as the program exists now, it is unlikely we can retire the $18 billion debt. I also see the risk that that would actually substantially increase in either a large-scale hurricane or a tsunami event. I think we do a much better job with riverine flooding and making the determination of how to manage that risk. But in these larger-scale events, there are structural issues within the Flood Insurance Program that produce high vulnerabilities that are not addressed in the current system.

So how do we address that risk? I think one of the issues that we see and we agree with is this risk should be better shared with the private sector *versus* strictly looking at a taxpayer-run system. I believe there are policies that could be moved to the private sector, that there are incentives, or pilots we could use to determine what would be the incentives. I also think there are going to be those policies that are such high risk that the private sector will never be able to manage that risk, and that will continue to be something we would have to look at as what would be the Federal share of managing or subsidizing that risk.

I also believe that the efforts to go forward in reauthorization need to take a longer view of reauthorization for a greater period of time than shorter-term reauthorizations. In our listening sessions with both constituents as well as the industry, they have informed us that it is very detrimental to have short-term reauthorizations, particularly in a real estate market that is trying to right itself. When we have lapses in the ability to write insurance or uncertainty in that, it makes it difficult for realtors and others to do closings as well as for write-your-own companies to be able to manage their portfolios and continue to offer those services.

So, again, I believe we need to look at in reauthorization how do we incentivize the program to encourage the private sector to participate, but also recognize there are going to be those higher-risk policies that we will still need to look at how the Federal Government does that.

We need to look at a longer reauthorization to provide stability as we go forward with these improvements. Even if we do not have all the answers today, I think that stability is the one thing we heard loud and clear that we needed to address.

Then, finally, the last piece of this that I think we need to look at is how do we deal with making this insurance more actuarially based, based upon the risk, which I think encourages the private sector to come into this market. And I am not opposed—I have heard this term that, well, why would we let the industry cherrypick the best policies and we keep the most toxic policies? The answer is the best market out there for getting this out of all Federal is to allow them to take those policies that they can manage the risk now. In many cases, those people do not buy flood insurance anyway because it is not mandated. Yet every time there is a declared disaster with flooding, we end up having to provide assistance.

So I am not opposed to the private sector writing the least risky policies if that would increase the amount of protection people have. But I also think—and this comes back to something we are struggling with every time we do map revisions or updates and we change the risk. When people find that their risk has increased and they are now required to mandatorily purchase flood insurance because they are in a high-risk area, the price of that oftentimes becomes a detriment to people and a brand-new cost that they had not anticipated in their mortgage or in their budgets.

So I think we also need to look at, as we change these designations, how do we do a graduated increase in these policies, how do we move people to be more actuarially sound, but also recognize for low-income areas, there may be a need to provide additional assistance or give more time before we get to a full adjusted rate more closely reflecting actuarial. And, again, these are some of the areas that I think—I agree with this concept that we have got to get the private sector more engaged in providing coverage in the flood insurance policy, and that could be either through direct provision, through reinsurance, or other models. But I also believe we still have a significant number of policyholders that it will still require some sort of Federal support to make it affordable and continue to provide that protection from these risks.

Again, I thank you, Mr. Chairman, for the opportunity to testify, and I look forward to the questions.

Chairman JOHNSON. Mr. Fugate, some South Dakotans have been told to evacuate for as long as 2 months. Can you tell me what actions you are taking in South Dakota to assist our communities and residents in this disaster? Can you also tell me what resources are available to South Dakotans while they are displaced and during the recovery phase?

Mr. FUGATE. Mr. Chairman, we are working with the Governor and the team there as we are getting moire and more flooding, looking at the assistance. There are two pieces of the assistance that can be provided. Obviously those people that have flood insurance would have that, but we also provide through other programs in a declared disaster. If the President grants a disaster declaration, that includes individual assistance. We do provide housing assistance and those types of support to the survivors in the event of a flood. So, again, we continue to work with South Dakota and as we go through the request from the Governor.

Those areas that do have individual assistance, that assistance is being provided for housing and other assistance based upon the impacts to their homes.

Chairman JOHNSON. In your testimony you outline several far-reaching NFIP reform policy alternatives that the NFIP working group has been discussing. When do you plan to publish some of these alternatives?

Mr. FUGATE. Again, we have looked at some very broad areas. In doing this what we found was there was no consensus, there was no single idea. But when we looked at both constituents and industry, we found there were about four areas—there seemed to be centers of gravity of interest. As we have done that and looked at that, we think some of those may not be the best way to go. I think we are probably now looking at focusing on a system that utilizes the Federal programs but with the greater participation of the private sector and how we do that. So as we continue to work through this summer, we are looking at later on coming up with a more consolidated recommendation and coming forth with the consensus report.

Chairman JOHNSON. As you know, we are facing a September 30 deadline for reauthorization. In the past many in the Senate have been reluctant to extend the program without reform. One of the NFIP reform policy alternative options you mention is program optimization. In this area of program optimization, what are some of the most important reforms Congress can make in the near term?

Mr. FUGATE. Well, I think one of the limiting factors in being actuarially sound is we are currently held to a 10-percent rate increase, I believe, per year in moving people that can afford the insurance to being more actuarially based. Again, this comes back to, as Senator Shelby pointed out, those that can afford the higher premiums, we need to be able to move them to those, but we also have to understand that low-income or people that have limited means, that creates a double impact in that we may actually be forcing them to make hard decisions about how they are going to pay for flood insurance. But I think the ability to move toward where people can afford the flood insurance to pay the actuarially sound rate without any reductions or phase-in time frames would be the first step, and then looking at how we take communities that because of the economic structures we phase them in more gradually. But as it is now, we are still having to move slowly through this, even for those people that cannot afford a higher premium.

Chairman JOHNSON. In your testimony you mentioned that the current in-or-out nature of the flood hazard areas sometimes gives citizens the impression that they are inaccurate. Do you have recommendations for how rates can be set in a more granular fashion? What resources would you need to achieve this?

Mr. FUGATE. Well, right now we deal with everything outside of a 1-percent flood zone as a preferred rate, and if you are in the 1-percent—which is another challenge is how do you explain the risk where we actually require the purchase of flood insurance is a chance of a 1 in 100-year flood, yet that does not mean that every 100 years you have a flood or it takes 100 years to have a flood. You can have these back-to-back events. And I think the question is where we see an increased risk but it is below a 1-percent or that higher level, do we still do preferred risk? Preferred risk is actually, I think, in some cases probably below what the market would actually insure at. So we actually—I think in some ways we have created the structural imbalance where we are charging a preferred rate because the risk is much lower, but we are probably writing it below what the private sector would be comfortable writing it as, and so we create a disincentive to get the private sector to look at that. In effect, and particularly in large-scale events such as hurricanes or tsunamis, we are actually subsidizing a greater risk there that when you look at river floods and other things suggests that that risk is not as great.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

The program's goal, as I understand it, of fiscal solvency is defined as charging premiums that will generate enough revenue to cover a historical average loss year. How does the program's rate setting policy compare to that of private sector insurers? In other words, would it meet the definition that I raised in my opening statement of actuarially sound?

Mr. FUGATE. I think we do a much better job on the riverine flooding. I do not think it is actuarially sound when you look at widespread impact, such as the hurricanes and the tsunamis.

Senator SHELBY. But if we do not get—first, define what actuarially sound means, and get to this, it seems to me that every time there is a catastrophic event and you are hit with everything, that it is leading the fund toward bankruptcy rather than actuarial soundness. Is that fair?

Mr. FUGATE. That is fair, Senator Shelby, but it also asks another question. It would be difficult to do that at a current rate that would be actuarially sound unless we had another way of distributing that risk, and since we are only writing that one hazard, without private sector engagement, it is hard to distribute that risk.

Senator SHELBY. And how do we change the distribution of the risk? Do we do that by mapping and by identifying and broadening the amount of money coming in? How do we do that?

Mr. FUGATE. One part would be to better reflect those areas and their risk and then have greater participation in the Flood Insurance Program based upon that risk. But I think the other challenge would be this is one risk. It means that every time you have significant floods, you are not able to balance that against other risks or other markets, and that is where the private sector, particularly in reinsurance markets, would give us more flexibility to share this risk against other risk so it is a more distributed *versus* all concentrated, that year to year, we probably do pretty good until we get a big hurricane or big tsunami, and then we are upside down again with large amounts of taxpayer dollars going to pay out the claims.

Senator SHELBY. Where are we in our mapping program, roughly, as to where we were, say, four or 5 years ago?

Mr. FUGATE. Senator Shelby, I would like to give you that in writing——

Senator SHELBY. Could you do that for the record?

Mr. FUGATE. Yes, sir, for the record. We have made significant improvements. However, as we have gone through this, we have learned some valuable lessons, one of which is to provide an unbiased science technology type review before we have disputes over our process. And so that is building a little bit more time in, but we continue to move forward——

Senator SHELBY. What is the impediment there, or the challenge there?

Mr. FUGATE. As we go through, because the funds that are available to do this, and as we hire the contractors to do the map upgrades and updates, we find ourselves from time to time dealing with technical issues and dispute resolution of using data that we have *versus* the local data or State data. Previously, we never had an impartial way to do the dispute resolution, so we have set up a technical advisory modeled after other dispute resolution processes using a scientific advisory panel to review our data and the local or State data and give us a better resolution that helps move that along.

Senator SHELBY. It is my understanding that FEMA has created a new category of what you call grandfathered categories for homes that have been mapped into riskier areas. These grandfathered properties enjoy, as I understand it, taxpayer subsidized flood insurance rates. Discuss how the newly grandfathered category works. Is it a permanent category? And do these grandfathered properties undermine your efforts at FEMA to place the flood program on a more actuarially sound basis?

Mr. FUGATE. Senator Shelby, I will speak in general and then I want to respond in writing to the specific details.

Senator SHELBY. Sure.

Mr. FUGATE. This refers to, as we know that we are having map designation changes, where prior to the updated maps, people did not either have a mandatory purchase requirement or had preferred risk, and as you go into the higher risk, those payments, or the amount that they would be required to pay has produced economic hardships.

What we do is we work with the local communities. If people will purchase insurance going into that, before the maps become final, they maintain a preferred status and they are graduated into the full status.

But again, it is an economic hardship, particularly these are not in many cases affluent communities. Oftentimes, what we find is these are existing communities, working communities, and it is a sudden and oftentimes very dramatic increase in their insurance premiums for flood insurance.

Senator SHELBY. Write Your Own Program. The GAO has uncovered several problems with the participation of Write Your Own insurers in the program. The GAO found, according to the report, that FEMA paid reimbursement rates that were greater than the actual flood-related expenses incurred by insurers and that the Write Your Own bonus structure is often excessive. Do you agree with the GAO's finding? If not, where do you differ?

Mr. FUGATE. We continue to look at that, but it is a question of incentivizing the private sector to write those policies, and so these are rates we negotiate with the Write Your Own policies. Again, we continue to look at the cost effectiveness of that, but it comes back to if the industry is not willing to do that at a rate that we can pay them, then we do not—we end up doing it ourselves.

Senator SHELBY. Could you comment briefly on the risk that exists for communities—you have seen a lot of this lately—that are located behind levees, flood walls, and dams, and whether there should be a mandatory purchase requirement for people living in these residual risk areas, or are they real risk areas, not residual.

Mr. FUGATE. Well, this is an area, again, of quite a bit of controversy. It is a zone we call Zone X. They are not required to purchase insurance because the protection of those structures reduces their risk below 1 percent. However, if you do have a failure, it is oftentimes catastrophic and many of those homeowners do not have flood insurance.

Senator SHELBY. What happens when they—the Corps, recently we have seen, breached the levee or the dam. What happens there, and there is no flood insurance?

Mr. FUGATE. In that particular case, Senator, that is a designed system. Residents in that floodway were notified and are notified annually they are in a floodway and that floodway may be activated——

Senator SHELBY. OK.

Mr. FUGATE. ——and they are required to purchase flood insurance.

Senator SHELBY. OK. Thank you, Mr. Chairman. Thank you.

Chairman JOHNSON. Senator Tester.

Senator TESTER. Yes. Thank you, Mr. Chairman, and I appreciate, Administrator Fugate, your recommendations on the Flood Insurance Program, and I particularly appreciate the short-term *versus* long-term argument. It has played havoc with the housing industry, a portion of our economy that we need to help promote. And so this flood insurance from a long-term basis is critically important.

I want to talk a little bit about a couple other issues first, though. On June 1, our Governor asked the President to declare a disaster for the State of Montana. Can you give me any insight on how close we are getting to this declaration from your level?

Mr. FUGATE. It is moving through the system, as we got the information and it is moving in the system, sir. It is at our level to be worked on, so it is not in the region anymore. We have it.

Senator TESTER. OK. And so you know I am going to ask a follow-up. Can you give me any sort of idea when we can anticipate this declaration?

Mr. FUGATE. Again, we will be—we want to make sure we have the best possible data to make a recommendation for the President and we will then await his decision.

Senator TESTER. OK. That did not answer my question. Can you give me any sort of idea on when that date might be? Is it going to be in a week? Two weeks?

Mr. FUGATE. It is moving through now, sir. I would say weeks, not months. I would be almost ready to say days, not weeks, but we want to make sure we have all the information to make the recommendation.

Senator TESTER. Good enough. Disaster Relief Fund, very quickly. This is kind of a follow-up on what I talked about yesterday when you were in front of the subcommittee yesterday. Are you confident that the Disaster Relief Fund will not be depleted in this fiscal year?

Mr. FUGATE. Based upon what we have right now, I think we will make it to the end of the fiscal year, but we have some costs that have come in on the most recent flooding and the recent tornadoes that we are having to evaluate and we hope to have some answers to that in the week, particularly with the debris missions in Mississippi and Joplin, Mississippi *[sic]*, we are adding those in and taking a look at those costs.

Senator TESTER. OK. We will need to stay in touch on that as it is moving forward.

Levee certification, it is a difficult problem. We have been in meetings together on this issue. And it is across the country, almost every river drainage. The Army Corps, they annually and periodically inspect levees that it constructed. However, the standards for the certification studies are incompatible with FEMA. FEMA and the Army Corps are not—and I am not being critical, but it is a fact—not on the same page when it comes to these certification standards. Has there been any discussion with the Army Corps about convening together to develop a common set of standards that would allow that the data collected by the Army Corps would satisfy your certification requirements in FEMA?

Mr. FUGATE. Senator Tester, we are working with the Corps. I think the answer to that in the short term is, yes, we are working toward that, but I think there is another piece of this. When we do our maps, we only looked at previously accredited levees, and if it was not accredited, we would map it with nothing, which did not reflect any protection or accurately do the risk.

We are currently working on and are submitting for review an ability to actually map the existing structure as is, so that where we have structures that may not be accredited but are there, we will no longer take the position that we are going to zero them out and map without the structures. That process will be going out to the internal review, and then we think in about another 30 to 45 days will go external, and we are moving toward using what is there *versus* a standard that says, unless you have an accredited levee, we will only look at that structure. We will now, after this process, look at structures that are there and then map what that risk looks like.

Senator TESTER. OK. So are we talking the same thing with accreditation and certification?

Mr. FUGATE. Yes, sir. Again——

Senator TESTER. That is good enough. So what about the levees that had been previously certified? And by the way, I appreciate that answer and I appreciate the work. What about the levees that had been certified before? What is the situation with those, because in my particular situation, some of them fall under your first answer. Some of them will fall under the answer that they are certified by the Army Corps and now that certification either does not work or the Army Corps says that we cannot certify anymore for whatever reasons, no money or liability, whatever it might be. So can you tell me, what about the levees that have been certified previously by the Army Corps?

Mr. FUGATE. The previous certification is—one part is are they currently certified, and as the Corps looked at what happened to failures, and we continue to see failures in levees this year, as they revise those standards, that is what an accredited levee becomes.

What we recognize is many levees do not meet that. It may be because they do not have on their free board or other design issues, but they offer protection. As we move toward factoring that in, I think it becomes less of an issue that we are not looking at levees unless they are accredited. We are looking at what is there.

But we will respond back in writing, sir, on where we are at on that with the Corps.

Senator TESTER. OK. That would be good. You know the issue. I know you know the issue intimately. What we have done through map modernization and whatever, through the Army Corps and FEMA not having the same standards, or whatever it might be, as we put communities in the situation where—and I have said this before to you, but it has been a while ago—where the folks that are going to do the certification, the errors and omissions here are so huge that the cost runs so high that it puts communities in rural America that are not exactly affluent in real problems with flood insurance. And so I look forward to working with you on this to try to get this done, because it impacts almost every community on every drainage, I think in this country, but I do know in Montana.

With that, thank you for being here.

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thank you, Mr. Chairman.

Thank you, Administrator, for your work, particularly and including the recent Mississippi River flooding which impacted many States, including Louisiana, although we were certainly not the most impacted.

I agree with virtually all of your comments. I want to underscore something you said, something Senator Tester emphasized, which is the need for a full-blown longer-term reauthorization. This reauthorization or extension in tiny increments has really not served our communities and the economy well at all, and I know you know that, and you reflected that in your testimony.

For instance, according to the testimony of Terry Sullivan, who is Chair of the Committee on Flood Insurance with the Realtors, the last lapse we had of the program in June of last year led directly to the cancellation or delay of 47,000 home sales closings at a time when, as Senator Tester said, we need every closing in sight in terms of trying to revive this economy and the real estate sector in particular, and for no good reason, we shut down permanently or temporarily 47,000 closings. So my first goal is a full-blown long-term reauthorization. I know that is shared on the Committee, and I certainly hope we get there.

Let me go to some particular issues of how we do that reauthorization. One is the current coverage limits. As you know, those have not been changed at all since 1994. That means the coverage limit, the amount, is a fraction, in real terms, of what it was in 1994. Do you think it is appropriate that we would look at that and adjust that in the context of moving the whole program to a much more actuarially sound footing?

Mr. FUGATE. Senator, I would actually—I had some conversations with some folks that have coastal property, as well, where their homes maybe in 1994 were $200,000 but now they are being appraised or their replacement cost would be a quarter-of-a-million or higher, and so we recognize that the Flood Insurance Program, particularly where we have had these homes that have appreciated so much, the insurance is not really covering replacement value. It may cover an existing mortgage, but it certainly is not covering what they have.

But coming back to what Senator Shelby said earlier, is it best that we do that through the Flood Insurance Program, or do we look at the Flood Insurance Program as a base level coverage and then look at how we bring the private sector in to provide a higher level of coverage? I would argue that if I have a home valued that much, I may be able to afford more than a working class fishing family that does not have that expensive of property.

So I guess the question is, as we look at those higher levels of coverage, do we do that at a full actuarial value with the Federal backing, or is this an area that the market may be interested in participating and that we do the base level coverage and they do a higher level.

But I agree. We have property out there that we do not cover the replacement cost with the Flood Insurance Program because of its caps, but in many cases, the way to go forward, I think, may be one of those opportunities to look at how we engage the private sector.

Senator VITTER. I am certainly completely open to that path forward as long as there is a path forward. I mean, right now, that opportunity for additional coverage is either not widespread or certainly not widely understood and taken advantage of, but I do not think it largely exists.

I want to go back to one of Senator Tester's comments, which is levee recertification. To me, at least in Louisiana, the biggest issue is something you did not particularly focus on, which is the fact that the Corps has basically walked away from their historic role in recertifying levees which they design and they built, and after Katrina, they basically said, we are walking away from that. It is all on the locals.

As a practical matter, it has just proved unworkable. We are talking about jurisdictions and entities which in 99 percent of the cases do not have either the expertise or the resources to handle that. And again, I am talking about levees that the Corps designed and the Corps built and the Corps checks on and the Corps is the logical lead agency, at least, in that ongoing recertification. Can you comment on that and how we can make progress on solving that issue?

Mr. FUGATE. Well, Senator Vitter, what we have done, I think, moves us beyond only looking at a levee that the Corps has accredited or the local jurisdiction accredits to those standards. We are working toward looking at the levees as built and using those to determine risk *versus* only looking at the accredited levees. So that is step one——

Senator VITTER. And let me just interrupt. Thank you for that policy change. That is enormously important. As you indicated, before you all made that major policy change, if it was not up to the 100-year standard, it did not exist on FEMA maps, did not provide any protection, which was not reality. So thank you for that change. But, as you know, my question still remains.

Mr. FUGATE. Again, we continue to work with the Corps on that. I know this is primarily where the ownership of the levee have transferred from the Federal Government to State or local jurisdictions and how do they maintain that accreditation, and that is something, again, we continue to work with our partners in the Corps, but I know it is a financial difficulty for local jurisdictions to have those levees, to maintain those standards. In many cases, it is the cost of having engineers come out and review the levees. Again, that is why we are hoping that as we go forward with looking at those levees that may not be accredited but are providing significant protection, how do we map that *versus* only accredited levees would be mapped.

Senator VITTER. Well, I just encourage you to stay involved in that, because the post-Katrina system is not working, and in my opinion, it is just the Corps trying to CYA, quite frankly, so the next time something bad happens, as it did in Katrina, they can point to somebody else rather than themselves, and we need a workable system. Thank you.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair, and thank you for your testimony, Administrator.

I want to echo what my colleague, Senator Vitter, has just said, that it is the sense of the many Oregon communities that the Corps has walked away from its historic role in certifying levees and left them in an almost impossible situation in which they cannot afford the private certification, but without the certification, their business districts and their housing districts are decimated. They are between a rock and a hard place, and I just want to make sure that those concerns of communities being decimated by this change of policy is getting to your ears.

I am not sure if you have been out to visit these communities and understand how this affects everything—homeowners who were not in a floodplain but are now in a floodplain and their mortgage company demands that they now get flood insurance, and they may be 10 years into their policy, businesses that cannot locate in the business district because they cannot afford the policies, the community hit hard by the recession, unable to fund the private certification process. That is assuming that all they have to do is get the certification, but the expectation is, well, the world has changed and now you are going to have to do X, Y, and Z to change your levee, which is a huge additional cost on top of the certification itself.

I just want to make sure that this incredibly important issue for economic development and the success of our communities is making it to your ears and that you are out talking to the communities that are affected and understanding it firsthand.

Mr. FUGATE. Senator, yes. In fact, our Region X Administrator actually was the former State Director and knows many of these issues. I personally dealt with Lake Okeechobee when the systems around that were not certified and we had to deal with the flood insurance premiums for rural agricultural communities. That is why I think our plan to move forward is to look at the existing structures and map those structures. If you are familiar with—unless they were accredited, we would not look at the existing structures in determining that risk, and we are moving——

Senator MERKLEY. Let me interrupt you there, because I was one of the Senators that advocated fiercely for that change. I do praise you for responding to our pleas on behalf of our communities. But let me give you an example of a community in my State, the community of Warrenton. Warrenton was in a situation of having to adopt the new flood zone before your change of policy, and so—and they had to do that because people could not afford flood insurance without adopting the new flood zone policies, or the new flood determinations, but they are now in the situation of—that plan did not take into account existing structures because it happened before you changed the policy. I praise you for changing the policy.

But how about for these communities that did not benefit from what is really a more accurate appraisal of flood risk? Can it be possible to go back and rework with those communities that were unfortunately hit a little before the change in policy?

Mr. FUGATE. Absolutely, Senator. As we go through our process of doing the internal review and now, I think in about 30 to 45 days, we are going to put this out to the external stakeholders for comment as we go forward with a rule, once we are able to implement the rule, we will go back and work with communities to update their maps based upon the new process. So it is not—it will not go as fast as I think many communities want, but it will go back and look at those communities where they did not have a certified levee and give us the opportunity to remap based upon the existing structures.

Senator MERKLEY. So I think that is great news and thank you. Do you anticipate, for example, for a community like Warrenton, just using it as an example, is that a year out or a couple years out, and is there a price tag associated with it?

Mr. FUGATE. Senator, could I respond back in writing on what—we are still going through the methodology to get that through the peer review and then go to the external stakeholders. I think when we have that, that will be about a 50-day process, and as we get the comments back, we will have to adjudicate and see. My staff feels like we have got the 80 percent solution, but we want to make sure we did not get unintended consequences or miss things.

But I would like to respond back in writing, that once we have the rule, what our time line would look like to come back and remap and what those costs would look like as far as resource availability.

Senator MERKLEY. I would appreciate that, and I understand it is a complicated process and they are trying to address it in a thorough manner and that would be very helpful.

In terms of the role of certification, the Corps has continued to play a role when there is a Federal structure involved, and I can assure you that we have been working with our communities to try to make sure we know about every Federal structure that could possibly trigger this policy. But is the current policy the one from here into the future, or just as Senator Vitter noted, kind of the walking away from the role of certification, is there a chance to walk back into that role and embrace it in a more wholehearted fashion?

Mr. FUGATE. Again, I will defer to the Corps of Engineers, but we do work very closely with them over the certification process, those that are still federally managed. I think this, again, is going to be a resource issue, in that how do we pay for or maintain the levees that are not Federal and understand that that is a tremendous burden and a cost for many local communities.

Senator MERKLEY. Thank you.

Chairman JOHNSON. Senator Johanns.

Senator JOHNSON. Thank you, Mr. Chairman. Thanks for being here.

I have just a couple of, really, quite specific questions that I would like to run by you. As you know, the State where I am from, the State of Nebraska, is bordered on the East side by the Missouri and we are now in this ramp-up where a historic amount of water is headed into the State, beyond anything the levees have ever had to endure, in fact, about twice as much water.

There appears to be three events involved that cause this issue. Event number one was rain in Montana, a historic amount of rain. Event number two, of course, is snow melt. Event number three is the release that necessarily has to occur by the Corps of Engineers to avoid dam failure.

As I understand the role relative to flood insurance policy, is you have to have it in place 30 days prior to the event. So how do you judge in this case when that 30 days starts to run?

Mr. FUGATE. That has been a very challenging question, is, does the flood event start when we start seeing actual damages or is it because we know the event is coming. I will ask, Senator, to respond in writing, because there are some very specific things that we had to go through to determine when does a flood occur by the legal definition and when is that incident period.

The challenge is that is when we stop writing policies. The reality is, even if people purchase the policies, if they flood inside the 30-day period, they are not going to be covered. This really gets back to when would we stop writing policies because there is a flood event or we are in a flood situation. But I would ask that we respond back in writing with specific details of how we go through that, because it does involve measuring certain things and going out and sending out adjusters to look at what is going on.

Senator JOHNSON. OK. If you could do that, I would really appreciate it, because we have many people, probably not just in Nebraska but all along the river system, that have this problem.

The second question probably is no less challenging. In a situation where you have the Corps come in and they certify a levee, and as a result of that, people are in the floodplain, they are out of the floodplain, people find themselves out of the floodplain and they do not need flood insurance for their mortgage, they are not worried about the flooding situation, and all of a sudden caught in this historic situation again, what happens to those people? What if they were to—are they treated any differently? Can they buy flood insurance? What is the situation for them?

Mr. FUGATE. Up until the point where a flood is occurring and we are still providing flood insurance, they can purchase flood insurance. If the flooding occurs outside of their purchase window, the first 30 days, they would have flood insurance protection. But this gets back to a very common issue we face, and that is even though you are not in the 1 percent or greater risk, it does not mean you will not flood.

And the reality is, if you leverage all the individual assistance programs that FEMA provides to a homeowner in an even where there is a flood, the Governors request the disaster declaration, and the President has granted individual assistance, it is a little less than $30,000.

So what happens to people is they end up losing everything. They cannot cover their mortgage. They cannot replace their home. And it generally, for many people in the middle class, is their most significant personal holding, and they are totally unprotected without flood insurance.

And again, this gets back to the root issue of as people who do not have flood insurance, whether it is required or not as part of their mortgage, are flooded, even when we provide Federal assistance, we do not make people whole, and it is, again, a program that was designed to prevent those kind of losses, but because people are oftentimes misinformed about their risk that they are not required to purchase it, therefore, they do not flood or do not need it, they find out, unfortunately, and we see this time and time again, where it is not only the impact of the flood, it is the financial impacts that many time are very difficult to recover.

Senator JOHANNS. I will just wrap up with this, Mr. Chairman. This is a tragic situation because the average person just simply would not go out and buy a flood insurance policy if no one is advising them that it is necessary. If they are not in a 100-year floodplain and the banker is not requiring it on the mortgage, *et cetera*, the average person would look at the cost of it and say, "Why would I?" And then you have the historic event, and they are just flat out of luck.

I guess what I would say to you, if you could get back with me on the issue I have raised, I would appreciate it, because this water is headed our way now, and next week I think we reach that maximum level of discharge by the Corps. And then I think it holds there into August, maybe all through August. I am going to guess I am going to have to get to know you a lot better in the months ahead, and probably a lot of other Senators will, too.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman.

First, thank you, Administrator Fugate. And before I get into the substance of my remarks, I want to thank you for being always responsive. We have had, you know, unfortunately, a number of disasters in my State during your tenure, and you have always been there and your folks have always been there, and I appreciate the hard work they do.

As you know, we have a huge issue on Long Island. It is one of the most important issues that Long Island faces. And what has happened is that people whose homes have never been flooded, who are as much as 5 miles inland, are being told that they need flood insurance, and it costs them up to $3,000. And these are middle-class people. This is not a farm community or a community by a river. These are suburban blocks. And they are befuddled. It is what makes people hate Washington, because they say, "I am being mandated to pay $3,000 when I have never had a flood and I am not near any crick, any stream, any water."

And so we looked into this, and it is tens of thousands of people. This is not a few idle homes. And we looked into this, and what we found was FEMA used information gathered by the Army Corps in Suffolk County, where there has not been as much of a problem—small—to draft Nassau County's flood maps. And they raised the level as to how high the house had to be above sea level. And, you know, when you do that in a relatively flat place, Long Island—I mean, I cannot imagine a storm that would flood things 5 miles inland from Long Island Sound or the Atlantic Ocean. If it is, we have got a lot more trouble than this.

But they used the wrong map to save money. That was what was told to us privately. Instead of doing a remapping in Nassau County, population 1.4 million, so I am sure it is—you know, it is not a small, little area. And Nassau has unique geography. It has different coastal and tidal characteristics than Suffolk County. It should have been subject to a separate study.

When people hear this, imagine, you are a homeowner, you are making $60,000, $70,000 a year, which is probably the average income in New York. That is not high, as you know, because our expenses are higher and our homes are higher. And you are told that you have to pay $3,000 because you might be flooded, and no ifs, ands, or buts, you can imagine people's reaction.

So what I am asking is two things: first, that—the best science was clearly not used in Nassau County, to take a county 30 miles away and say we are using that—will you support starting the remapping process over so we can get an accurate look at Nassau County? It is just not fair to use Suffolk County's data. No one revealed that to us. We found that out ourselves, but the Army Corps has confirmed it.

Mr. FUGATE. Senator Schumer, we will work on the Corps. We have new updates for other parts of that basin, and we are responding back in writing to your request, and we are going to outline how we are going to address the issue as we go in and do more of the studies that are going to include other areas as well as the area that you have mentioned. So we are working on that. We will have a response back——

Senator SCHUMER. You mean other areas in Nassau or other areas in general?

Mr. FUGATE. Other areas in general in that basin, and we are going to take advantage of that to actually focus on the areas you have identified.

Senator SCHUMER. The whole area by Valley Stream, the 40,000 houses.

Mr. FUGATE. Yes.

Senator SCHUMER. And will I be happy with this letter?

[Laughter.]

Mr. FUGATE. Unable to say, sir, but it will be responsive, and we will continue to work with you.

Senator SCHUMER. OK, because I am not going to be happy unless we really deal with this problem. OK? All right.

Second, while we are waiting to deal with the problem—and I am glad you said something is going to be done—FEMA rightly decided to extend eligibility for the PRP, the preferred risk policy, so that the people do not get the jump for 2 years. Could you please address if we can extent that beyond the 2 years until we get a fair adjudication of what is happening in Nassau County? Because it may not be solved within 2 years, extending the PRP, which, as I understand it, is totally in FEMA's discretion.

Mr. FUGATE. Again, we have that request. We are working with our chief counsel to respond to that to determine if we can do that.

Senator SCHUMER. Well, what would be the reason you could not?

Mr. FUGATE. I would have to defer back to our chief counsel to make sure that as we go forward we are giving an accurate answer.

Senator SCHUMER. OK. Well, look, I feel very strongly about this, and, you know, I am prepared to do whatever it takes around here to get fair treatment for these 40,000 people, because they have not been treated fairly by FEMA. I do not blame you, but to save a million bucks and use a different place and graft it onto Nassau County and then tell so many people that they have to pay so much more in a place that has never had a flood in the history—you know, since our known history, 5 miles inland, with no streams, no cricks, no rivers, no bays, we have got to do something about this.

Mr. FUGATE. I understand, Senator.

Senator SCHUMER. Thank you.

Chairman JOHNSON. Senator Kirk.

Senator KIRK. Thank you, Mr. Chairman.

I will be much easier on you. You did a hell of a job in Illinois, and we had quite an inundation, and I just checked with my team in southern Illinois. High marks. Very high marks.

I also want to thank you for working with me and Jerry Costello on this policy of not recognizing any levee at all. Your letter was detailed. You are working on it. I very much appreciate the comeback.

I want to talk more generally about the program. My understanding is you are about $18 billion in the hole right now?

Mr. FUGATE. Yes, sir.

Senator KIRK. And we have this policy—the program has been rolling since 1973. We have this policy of repetitive loss, which is now a third of all your losses. Any way we can just not reauthorize this, kind of like three strikes and you are out, rather than having the Federal taxpayer getting taken to the cleaners over and over again?

Mr. FUGATE. Again, I defer to this body. It is, again, on the one hand, yes, we do have repetitive loss properties. We have to ask the question: How long do we continue to subsidize that risk? But then we have the situation where we get the request from the same body to provide that assistance?

Senator KIRK. I notice in this hearing everybody is sort of asking you for money, but you have lost quite a bit of money. And if you were a private sector entity you would not have the constraints that you have now which require you to lose money.

Mr. FUGATE. One of the options—and, again, oftentimes a preferred course is to buy out those properties so they do not flood in the future. And this is done in partnership with State and local governments. Where we have done buyouts successfully, some of this recent flooding we have had has been less severe because homes that previously flooded had been bought out. But it again points out: What is the appropriate level to subsidize risk? And how long should that risk be subsidized before we say it is no longer going to be managed that way?

Senator KIRK. And I worry that Government always makes the wrong decision because Congress pressures it to lose money as opposed to a private entity, which, you know, clearly would not write the policy after the third loss.

What about sunsetting prefirm? Certainly with the House bill, at least we are making the decision on vacation homes, *et cetera*. What about sunsetting the whole thing so we can finally have the map determine the risk?

Mr. FUGATE. I would look at it as for those that could afford it, it would be a shock and somewhat painful, but it would not result in them defaulting or losing their homes. I think there are real issues with lower-income and fixed-income people that a sudden increase in premiums, as much as several thousand dollars that they had not budgeted for, would be extremely detrimental.

So I would look at how do we do this for those that can afford it, and should we look at some way to continue to support those that this would create a hardship that could actually result in them losing their home or their ability to stay in their community?

Senator KIRK. We just had news across the wire about an hour ago that Treasury has now said that our debt is now going to exceed our national income this year rather than 3 years from now. So the question is: Since we have been underwriting these guys since 1973, perhaps it might be the time to stop.

Mr. FUGATE. This is the body that can make that determination, sir.

Senator KIRK. You are with me. And then how about sunsetting the grandfathering? The Senate made this decision in its legislation.

Mr. FUGATE. Again, the program will go as it is directed. This was a request that was put in to minimize the impacts as the new maps came out and provide that grandfathering. Certainly this is something this body can do. I would caution, however, the unintended consequences of which could result in impacts to those that cannot afford this, and it may be causing adverse risk that we did not anticipate.

Senator KIRK. The problem is we are subsidizing people building and investing in floodplains and then getting wiped out periodically.

Mr. FUGATE. I would suggest that those that want to build new structures in high-risk areas, it would be better if they were assuming the full risk and not the taxpayers. But I am concerned about the existing communities that are there already and what that could do to local economies if we price people out of their homes because of the insurance cost.

Senator KIRK. I think there would be a growing concern, Mr. Chairman, on this Committee that the program be allowed to recover its own costs.

I think that Congress is actually the problem, not you. The direction I am hearing you want to take is that we would be far more sound in the running of this program if we allow you to make these decisions, and for a program that is a significant drag on the Treasury, it seems like operating it in that way, as we just heard the news this morning that our debt has exceeded our national income, might be the way to go.

Mr. FUGATE. Well, another thing, Senator, is you start moving to more actuarially based, as how do we encourage the private sector to take on some of this risk. I think we are going to still have the highest risk properties as some form of Federal program. But as we move to looking at how to engage the private sector, I think we can distribute and manage that risk better in a private sector market than just looking solely at one that we are trying to administer within the Federal Government.

Senator KIRK. I just would hope that maybe we could give you one overarching authority saying notwithstanding any other of the directions we have given you, you have overarching authority to waive the requirements of Congress so that the program can be run without cost to the taxpayer. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Fugate, what happens if this program ceases to exist, we let it lapse? Tell me what happens in the real estate market.

Mr. FUGATE. What would happen is you would have both the Federal Government and any hope of getting the private sector back into underwriting mortgages walk away from all properties at flood risk. This is what happened in the 1960s when the private sector determined that they would no longer cover flood as a risk. It put the financial institutions of this country and, more importantly, the taxpayer at an uncovered risk that is in—I would not even fathom to guess what the trillions of dollars of exposure looks like on flood. But what happens there is this is a hazard that currently the Federal Government is the primary provider of that coverage. Without that, those people that live in the highest-risk areas may not be able to receive financing for their homes, and I think you would end up in a situation where the exposure would be so great that the original intent of this program to protect the mortgages would come back and it would, I think, eviscerate the housing market even more than we have seen.

Senator MENENDEZ. Which would be an enormous body blow to this economy that is already struggling to recover. So with that as a premise, it seems to me like we need to act, so then the question is what do we do.

Let me ask you, you know, in March, in my home State of New Jersey, the Governor filed a request for a Federal disaster declaration. FEMA denied it on the basis that minimum uninsured losses impacting individuals and families took place. But isn't that, in essence, a perverse incentive—or disincentive? I mean, the reality is, it seems to me, that at a time when we are trying to encourage communities and individuals that it is in their best interest to participate in the program, does it make sense to penalize communities that have been proactive and successful in getting their residents to purchase insurance?

Mr. FUGATE. Being the FEMA Administrator where we administer the individual assistance programs that would have come to bear for the uninsured, but also running the insurance company, I feel that way many days. But I also recognize that our FEMA programs will not make people whole. Even if they had gotten a declaration, the most we are going to provide to a homeowner, if they qualify for everything, which is very unlikely, would not even begin to cover their mortgage or replace their homes. Most recently, last year in the Tennessee floods where all the damage was flood related, the average amount that we provided to a family was less than $7,000. So going the individual assistance route in lieu of flood insurance has not worked, and although——

Senator MENENDEZ. I agree with you on that. But the question is: Here are communities that, for the most part, have accelerated their participation in the Flood Insurance Program, yet they get punished for those who do not have the flood insurance, and certainly that would certainly be helpful to them to have assistance to be able to meet the challenge in their families. And yet, you know, so those communities that do not participate to the level that many in New Jersey do, they get the benefit. The communities that do participate get a negative. It seems to me to be a perverse incentive, you know, or disincentive.

Mr. FUGATE. Senator, this is the one hazard that that situation exists. The——

Senator MENENDEZ. Let us talk about another hazard. With billions of dollars spent each year on disaster assistance, much of which is going to people in communities who are uninsured, do you believe that it would be cost efficient to provide vouchers to help low-income families afford flood insurance, especially those who are now faced with all new flood maps and, you know, encountered in this set of circumstances?

Mr. FUGATE. That is one option, Senator, we have looked at, as we try to move to more actuarially based and continue to increase participation for low-incomes in a voucher system. The question would be: Is that going to be sustainable? Because if we do it for the first year, what about the out-years? I think if it is something where either we do vouchers or we do some sort of adjustment based upon the income to continue some level of participation and protection, those are desired outcomes. And, again, it would have to be something to sustain.

What we do right now in our FEMA programs is if you do have flooding and you do get individual assistance, we require you to purchase flood insurance for the first year, and then you have to maintain it for future years. We will oftentimes go back to a community 3 or 4 years later where there is a flood and they have discontinued their coverage because they either did not want to or could not afford to continue to pay for flood insurance.

Senator MENENDEZ. It seems to me that we need to do something to help those individuals now caught in this set of circumstances and yet do not have the wherewithal, certainly at the start where they are facing premium shock.

Last, I was a mayor at one time, and, you know, the nature of a mayor's resources is their ratable base, for the most part. In our effort to eliminate severe repetitive loss properties, shouldn't we be considering a way of incentivizing in those communities that face—this is about a third of all of the flood insurance plan claims are made about 1 percent of these types of properties. Shouldn't we be looking at how we maybe work to offset some of that ratable loss in a way that still would be an enormous savings to the program but would incentivize mayors to say, OK, let me take this property off the ratable base?

Mr. FUGATE. It would be another way of encouraging that. Our current buyout programs, one of the limiting factors that I hear from my peers at the State and local level is a cost share, and particularly in trying to buy out properties to get those properties out of those rating systems, is, you know, how much money we have, how many properties can we buy out, and how do we factor that into those ratings.

Senator MENENDEZ. But the buyout—my last point, Mr. Chairman. The buyout program is about how much money will it cost to buy the property, but there will be many municipalities that will look and say, well, I am going to lose all those ratables and, therefore, going to be resistant. When a third of all of your claims end up being 1 percent of those repetitive losses, it seems to me that it makes economic sense to figure out how you incentivize eliminating as much as possible of that 1 percent of repetitive loss properties. So we look forward to working with you on this.

Chairman JOHNSON. Senator Moran.

Senator MORAN. Thank you, Mr. Chairman.

Administrator, thank you. Two days in a row of your testimony. It has become even more exciting as the day goes on. I appreciate the conversation that I have heard. I would like to ask you to include me in the letter that you apparently are going to send to Senator Johanns in regard to in-progress flooding. That is an issue for us along the northeaster border of Kansas. The Missouri River creates our border.

Also, I wanted to see if you had any sense that there is any need to address what I see as perhaps a bias against rural disasters in regard to a disaster declaration and FEMA's assistance. We have a number of instances in which because of its rural lower property values, smaller population, the tornado or the flood is just as damaging to the folks who are affected by that, but we do not reach the threshold necessary for a Presidential declaration. Just recently one of our counties, Clay County, had 100 percent of their roads damaged by a flood, but the value will not meet that. Redding, Kansas, tornado, very low property values, a small community, almost totally devastated, but, again, will not meet the threshold. We are not looking for expanding the cost to FEMA, but I want to make certain that—or to the taxpayers. I do want to make certain that we do not have a formula that unnecessarily excludes folks who happen to reside in rural America. Any thoughts about that?

Mr. FUGATE. Yes, sir. Coming from Florida, which many people think is only big cities or South Florida, I come from a rural part of the State with small rural communities. However, the Stafford Act and the request from a Governor is judged against a State and the population. And so it does put a disadvantage to smaller communities, the theory being the State does have the resources in many cases, if it is a small impact, to support those communities. So it does look at the impact to the State. It looks on a per capita State basis. And then we look at the per capita impacts within those communities. And we have taken into account and do look at the severity of impact of what it looks to a local community, particularly in determining at a Governor's request what counties to include in the initial declaration. But it does look at the State and the State resources *versus* just looking at the community that was impacted.

Senator MORAN. Let me make sure I understand what you told me. When you say you look at the community and the damage per capita, is there a way to override that State—in our case it is $1.31 per capita—and receive that designation?

Mr. FUGATE. There are times when the severity or the intensity of an impact would not reach a State per capita, but it would warrant a decision to support a declaration. Again, this is why FEMA does the write-ups and works with the State, but ultimately this is the President's determination. But there have been times where we have had such an intensity of impact in a community that you did not meet your State thresholds, but the impacts locally were so catastrophic to warrant that assistance.

Senator MORAN. It is my experience that in at least many of those small rural communities they have the least amount of preparation, expertise, responsibility as compared to a larger community that has more professional ongoing planning and response to that kind of disaster. I would welcome the chance to explore that issue myself further, and with your help. I would welcome your help.

In the idea of saving some money, one of the things that made some sense to me, you talk about in your testimony the importance of the affordability of coverage, and I am interested in knowing what it would take in order for premiums to be escrowed, similar to property taxes or homeowners insurance. Could that help better manage the issue of affordability? And do you have the authority to escrow payments?

Mr. FUGATE. Senator, I am going to respond in writing to that because there is another piece of that that we are exploring and we have been asked to look at. But how to build this into—just like your other insurances, your property taxes, into your payment, rather than this be a separate bill that comes up and is due all at once.

We have also looked at and have been asked to look at quarterly payments. I think we are—I am principally in favor of looking at making this fit the other insurance models and fitting the escrow model, but also allowing people to do quarterly payments so long as people understand they just do not buy a quarter when they think they are going to flood. They buy a year's worth of insurance. They are going to make payments against that and they are not just buying a quarter's worth.

So we are looking at how to do that. I will ask to respond back in writing. But, again, if you can build this into the recurring costs of mortgages and treat this more like we do other types of insurance where people may want to buy this as a separate policy. Right now it is a lump sum, so we are looking at how to provide this as a similar process that is used for other types of policies.

Senator MORAN. If you concluded that this was an appropriate opportunity, do you have the authority to allow escrow or quarterly payments?

Mr. FUGATE. We are working on that, and we will respond back in writing what we can and cannot do.

Senator MORAN. Thank you, Administrator.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman, and thank you, Director. I want to thank you, first of all, for your assistance last year for the floods in Rhode Island. I was repeatedly stopped by my constituents who went out of their way to commend FEMA for their efforts and for not just doing the job but going above and beyond, so thank you for that. I think that ethic begins at the top, so thank you very much. Well done.

A lot has been discussed about mapping. Your risk map program is designed to ensure that by 2014 the goal of 80 percent of the Nation's flood hazard data or new updated data are deemed valid. My sources indicate we are at about 55 percent at the end of 2012, so how do we in 2 years go from 55 to 80 percent, particularly with constrained budgets?

Mr. FUGATE. Senator, we are not.

Senator REED. OK.

Mr. FUGATE. To be honest. In looking at where we are having to make targeted reductions in our budget, we have looked at reducing funding for map modernization. But we are not stopping map modernization. But it will take longer to complete the work.

Senator REED. And how does that play out now when—for example, my colleague Senator Schumer was talking about issues in his part of the country. We have areas which are not in flood zones, and then some that should be, *et cetera.* How does that play out on the ground like today as flooded rage through the country? I would think that the maps would be sort of the first place you would want to—the first priority, because then you can decide who must have insurance, who should not have insurance, and right now that is all based upon in many cases a lot of 35-year-old data from the U.S. Geological Survey.

Mr. FUGATE. Again, Senator, it is not an easy choice, nor is it a preferable choice. I think that the best data we have—and, again, part of this has been oftentimes challenges to the data we have produced, having to go back and validate that, and oftentimes a restudy at the request because data—the outcomes were not what people thought it should be. And so that increases the cost. But I do agree. The best way to start is always to know what your risks are and to have accurate maps, not only for the purposes of insurance but, more importantly, for zoning and development so we can make better and wiser choices that we build in places that have the least amount of risk and we mitigate against a risk where we know the hazards.

Senator REED. Has there been any discussion or thought about trying to develop a joint enterprise to do this with the private sector, with State governments, with county government who I would think also have a vested interest in starting with good data, not writing policies on data they know is wrong?

Mr. FUGATE. We do that, and speaking from my experiences in two cases where I know this was done successfully, one was in North Carolina in the aftermath of Hurricane Floyd where they actually were able to utilize mitigation dollars from FEMA in the aftermath of a disaster to produce very high resolution flood maps. My experience is in Florida where we were mapping coastal communities to get higher resolution maps for storm surge, and then applying that for future map development. But I think you point out a key issue. Much of what we are doing is establishing what are the digital elevation maps. There is a significant economic advantage as we build, whether it is flood insurance, whether it is highway, whether it is water management districts at State or local programs, to be able to integrate all this digital elevation data into a national atlas, not o you does it provide us the tools for flood insurance, it is a significant economic tool to have the best available data for people planning and looking at future growth, construction, all the way through to agriculture.

So I am firmly committed that as we do this mapping, the baseline data, as much as we can either leverage what other people have done or we can fill in gaps, so we are working more with the interagency of the Federal programs to make sure that we are identifying where we are doing mapping, other people are doing similar work, and making sure we can maximize our investment.

Senator REED. Again, a final point on this, and I agree, these are very difficult judgments that you are making. You have been given this responsibility, and you are providing a general good, a social good that lots of other people depend upon, and if they could be encouraged—and, in fact, could see the wisdom that they could—it would make sense for them to participate to help us, and not just localities and States but private entities. And with technology today, the ability to map things from the sky and to do it quite accurately and to—you know, I think that might be an approach that would take some of the burden off of you, which you have had to historically. But, once again, let me conclude by thanking you for the great effort last year in Rhode Island.

Mr. FUGATE. Thank you, Senator.

Chairman JOHNSON. I would like to thank our witnesses for being here today to contribute to our NFIP reauthorization discussion. The NFIP has an important mission: to aid in disaster mitigation and recovery. Today's discussion will assist us as we chart a sustainable future for the program. This hearing is adjourned.

[Whereupon, at 11:36 a.m., the hearing was adjourned.]

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

## PREPARED STATEMENT OF CHAIRMAN TIM JOHNSON

Today, the Committee meets to examine the reauthorization of the National Flood Insurance Program. Currently, constituents from my home State of South Dakota are dealing with some of the worst flooding that the State has ever seen. When I was back in South Dakota last week, I spent some time talking to homeowners and business owners in the communities that are anticipating some of the worst damage. While they are working hard to minimize harm to people and property, they are understandably concerned about short-term displacement and long-term recovery. I will do my best to see that they, along with our neighbors and fellow Americans who have had their lives turned upside down by devastating storms, are promptly provided with the disaster relief that they need.

I would like to also applaud Administrator Fugate and his staff at FEMA for how they have responded to the flooding in my State so far. I hope that the quick response that we saw during the recent southern storms continues when addressing the ongoing flooding in South Dakota and around the country.

The NFIP was created to help communities limit damage and speed recovery from flooding disasters. However, it now faces several challenges to its long-term viability, including an $18 billion debt to the U.S. Treasury.

Over the past year, we have also faced several lapses in the NFIP. As many stakeholders have noted, lapses have detrimental effects on both the insurance and housing markets. This program, which provides over $1.2 trillion in coverage, needs certainty. It is my hope to provide this through a long-term extension.

As the people of South Dakota and others have seen firsthand, flooding is responsible for more damage and economic loss than any other type of natural disaster. It affects people across the Nation, of both parties, which is why I believe that in 2008 the Senate was able to come together across the aisle and pass a bipartisan reauthorization bill by an overwhelming vote of 92–6. Unfortunately, in 2008 we were not able to come to an agreement with the House.

The recent flooding has made it clear that Congress must reauthorize and reform the NFIP which is set to expire this year on September 30th. As we move ahead, I hope that we can once again come together and pass a bipartisan bill that will build a sustainable future for the program and American citizens.

## PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you, Mr. Chairman.

The National Flood Insurance Program was established in 1968 and was designed to reduce the burden on taxpayers stemming from Federal disaster relief for floods. By providing flood insurance for properties in high risks areas, it was hoped that insurance premiums could be used to cover the costs of flood damage.

Since Hurricane Katrina, however, the Program has struggled to remain financially viable. In fact, since early 2006, the GAO has targeted the Flood Insurance Program as "high risk" because of its mounting debt and the structural flaws. Today, the program is nearly $18 billion in debt and has problems even servicing that debt.

Unfortunately, as the GAO has shown, the program's debt is only one of many difficulties facing the flood insurance program. Every aspect of the Program must undergo significant revision for it to survive and continue on a sustainable path.

During the 109th Congress, this Committee approved unanimously, and the Senate overwhelmingly passed, legislation that, while not perfect, addressed many of the core deficiencies of the program. That legislation would be a good starting point for this Committee as we move toward reauthorizing the National Flood Insurance Program.

As we begin this process, I believe several issues deserve a close examination by the Committee. First, we should examine the relationship between the Program and the Write Your Own insurance companies. According to the GAO, Write Your Own companies may be receiving excessively high reimbursements and bonuses from the Program. The GAO recommended that the Write Your Own program have more transparency and accountability. This is something we should pursue.

The Committee also should examine the types of properties the flood insurance program is covering to ensure that its resources are spent effectively. For example, the Congressional Budget Office has determined that 12 percent of the homes covered under the program are worth more than $1 million. We must ensure that the Program requires wealthy participants to pay the full costs of their insurance.

The Committee should also examine the Program's map modernization effort. The map modernization process has been ongoing for several years and is crucial for the long-term success of the program. Updated maps are important for two reasons.

First, they warn developers and homeowners about the risk of developing or living in a floodplain. Second, they ensure that participants are paying fair prices for flood coverage.

Some communities have called into question the validity of the maps and others have argued that they have been excluded from the mapping process. Community participation is crucial, but this process needs to take place rapidly to ensure that the risk is accurately reflected and homeowners and communities are fully informed. Many of the existing maps are several decades old and do not accurately reflect the costs and risks of living within a floodplain.

I also would like to see a simple definition of the phrase "actuarially sound" in any bill to reform the Program. This simple act will clearly State our intent to make this program self-sustaining.

Finally, I believe this Committee should consider ways to privatize portions of this program. We should transfer risk from the Program to the private sector to the maximum extent possible.

If we are able to accomplish these objectives, we may finally achieve the original purpose of the flood insurance program; to reduce the escalating cost of flooding to taxpayers.

Thank you, Mr. Chairman.

## PREPARED STATEMENT OF SENATOR ROGER F. WICKER OF MISSISSIPPI

Thank you, Chairman Johnson and Ranking Member Shelby, for holding this hearing on the reauthorization of the National Flood Insurance Program. I appreciate the opportunity to testify before the Committee this morning, and I commend you for taking this first important step toward reforming NFIP this session of Congress.

Less than 1 year ago I came before this Committee and testified in support of modernizing and reauthorizing the National Flood Insurance Program. Last year, NFIP lapsed three times before the Senate authorized a 1-year extension. As you know, that extension expires this September.

Another program lapse is entirely avoidable, and we should not allow that to happen. Similarly, another short-term extension of a flawed program would be unacceptable to me, as I believe it would be to most Members of the Senate. I urge my fellow Committee Members to enact a multiyear reauthorization and in the process fundamentally reform this program.

The National Flood Insurance Program is the source of protection from flood risk for most Americans. Nationwide, 5.6 million NFIP policies were in effect last year. Lapses and short-term extensions of the program create uncertainty and unnecessary burdens for property owners who depend on NFIP. Lapses also drive up the cost of administering the program and interrupt economic activity, including purchases of homes and other properties that require proof of flood insurance prior to closing. In speaking with Mississippians, it is clear that a long-term reauthorization with targeted reforms is necessary for coastal communities to prosper.

Though most Americans who need flood insurance rely on NFIP, the program itself has become insolvent and remains nearly 18 billion dollars in debt. Without appropriate reform, modernization, and an extended reauthorization, our Nation and the American taxpayers face serious consequences when—and it is only a question of when—the next big natural disaster occurs.

In my testimony of last year, I outlined specific reforms that would help put the NFIP back on a sustainable trajectory. These included:

1. Improving enforcement by FEMA and lenders with respect to those required to purchase and maintain flood insurance.
2. Charging rates that are actuarially sound and offering meaningful premium reductions for mitigation improvements.
3. Updating FEMA's flood insurance maps so that those in flood-prone areas are aware of the risk and obtain proper insurance coverage.

Perhaps the largest threat facing NFIP, and the one responsible for the vast majority of its current debt, is that of major hurricanes making landfall on our coasts. In 2005, hurricanes Katrina, Rita, and Wilma impacted a wide swath of the United States. According to the Congressional Research Service, NFIP accrued approximately $17 billion in debt from flood claims caused by these storms alone.

It has been 6 years since Hurricane Katrina devastated the Gulf Coast. While we have made significant progress in rebuilding our communities and businesses, for many Mississippians recovery is still not complete. One of the greatest impediments to our efforts is the lack of affordable property insurance. The availability and affordability of wind insurance is crucial in any State where there is coastal exposure. For vast numbers of property owners, private insurance coverage for wind damage has not been available on the Gulf Coast since the 2005 hurricane season.

Hurricanes present a unique problem for coastal property owners because damages can be caused by multiple perils, including high winds and devastating storm surges. Currently, homeowners cannot purchase a single insurance policy to cover all hurricane-related risks. Wind losses are covered by private insurers or State-run wind pools, while coverage for flood damage is largely backed by the Federal Government through NFIP.

Many homeowners who suffered ruinous property damage from Hurricane Katrina were forced to go to court to determine which insurer was responsible for damage in wind-*versus*-water disputes, even when they had appropriate coverage. Other property owners failed to purchase flood insurance because they relied on outdated Federal flood zone maps that indicated they were not at risk for flooding. When their property was damaged by the storm, many insurance adjusters concluded that property damage had been caused by water alone and denied legitimate claims altogether.

In 2007, the Government Accountability Office issued a report which called for greater oversight of wind and flood damage determinations. In that report, GAO found that claims information collected by NFIP did not allow FEMA to effectively oversee damage determinations and apportionments after hurricane events.

In the words of the GAO, " . . . for a given property, FEMA's ability to assess the accuracy of payments for damage caused only by flooding is limited because NFIP does not know what portion of the total damages was caused by wind and what portion was caused by flooding." The report continued, "because both homeowners and NFIP policies can be serviced by a single Write Your Own private insurer, a conflict of interest exists during the adjustment process."

To help resolve these issues, I recently introduced the Consumer Option for an Alternative System to Allocate Losses Act, or the COASTAL Act. This legislation, S. 1091, addresses several problems that arose in the aftermath of Hurricane Katrina. Those problems include:

- Disputes and costly litigation between consumers and insurers over wind-*versus*-water claims.
- Inherent conflicts of interest that can arise when the same claims adjuster assesses damages that are and are not covered by his employer.
- Lack of oversight with respect to the adjustment process and claims paid by NFIP.

The COASTAL Act is a commonsense approach to addressing these problems. This legislation would use data currently collected by the National Oceanic and Atmospheric Administration (NOAA) and other participating entities to allocate property damage following significant storms.

Under the COASTAL Act, a formula would be established that utilizes storm information provided by NOAA and its partners, combined with structural information for each property, to allocate losses caused by high winds and storm surges from hurricanes. This alternative loss allocation system would be based on the timing, location, and magnitude of wind speeds and storm surges before, during, and after a major storm impacts the coastline of the United States.

Only properties that are completely destroyed by a hurricane, leaving little but foundations behind, would qualify for this alternative loss allocation system. "Slab" cases, as they are commonly know, have the greatest uncertainty, because there is little to no evidence left to make an accurate adjustment using current practices.

The COASTAL Act is by no means a silver bullet for all of the problems associated with flood insurance and NFIP. However, this legislation is a fair and objective way to provide more certainty to the slab claims process, which is a very costly piece of the greater flood insurance problem.

The advantage of my proposal is that it is based on activities that NOAA already carries out. Extensive storm data related to winds and storm surges is currently collected throughout each named storm that threatens the coastlines of the United States. This is done primarily for purposes of doing a better job of informing emergency managers of imminent threats. I would emphasize that the COASTAL Act does not create a new Government program—rather, it adds further utility and purpose to existing Federal efforts.

I believe this proposal will provide more structure in the marketplace, which should increase the availability of insurance and competition while driving down premiums over time. It is also my belief that this system will help us hold insurance companies accountable for covered losses, as has proven necessary in some cases, rather than forcing taxpayers to foot the bill through the deeply indebted NFIP.

A year ago I held an insurance roundtable in coastal Mississippi to hear the concerns of those still recovering from Hurricane Katrina. There is no question that one of the most difficult obstacles to recovery from previous storms and preparing for future events has been the cost and availability of insurance.

NOAA's hurricane outlook for 2011 indicates an active Atlantic season. Congress must take the initiative now to put the National Flood Insurance Program on a sustainable path forward. I will continue working with my colleagues on the Committee to pass a reauthorization bill that can be signed into law before the end of the fiscal year, and I urge all Members to join in this effort.

Thank you.

---

## PREPARED STATEMENT OF W. CRAIG FUGATE

ADMINISTRATOR, FEDERAL EMERGENCY MANAGEMENT AGENCY

JUNE 9, 2011

### Introduction

Good morning Chairman Johnson, Ranking Member Shelby, and distinguished Members of the Committee. My name is Craig Fugate, and I am the Administrator of the Federal Emergency Management Agency (FEMA). It is an honor to appear before you today on behalf of FEMA to discuss the National Flood Insurance Program (NFIP).

The NFIP serves as the foundation for national efforts to reduce the loss of life and property from flood disasters, and is estimated to save the Nation $1.6 billion annually in avoided flood losses. By encouraging and supporting mitigation efforts, the NFIP leads our Nation in reducing the impact of disasters. In short, the NFIP saves money and, more importantly, lives. While the NFIP has experienced significant successes since it was created more than 40 years ago, there are a number of challenges currently facing the program. The most significant challenge is balancing the program's fiscal soundness with the affordability of flood insurance. The NFIP must continue to offer affordable insurance that will properly identify those properties at risk and provide them adequate coverage, while reducing the need for taxpayer-financed disaster assistance.

In my testimony today, I will provide a brief history and overview of the NFIP and discuss critical changes FEMA has made to the program over the years. I will also discuss the recent efforts of FEMA's NFIP Reform Working Group, which is developing policy recommendations for comprehensive NFIP reform for the Secretary of the Department of Homeland Security. It is important to note, however, that the Administration has not taken a position on the preferred course of action for NFIP reform and that these are currently draft proposals from the NFIP Reform Working Group.

Congress has been a valuable and important partner in all of our NFIP efforts, and we appreciate your attention to this important matter.

### Overview of the National Flood Insurance Program

The NFIP is designed to insure against, as well as minimize or mitigate, the long-term risks to people and property from the effects of flooding, and to reduce the escalating cost of flooding to taxpayers. Flooding can occur along river banks, or result from weather-related coastal hazards, such as hurricanes, storm surges, or tornadoes. More than half of the U.S. population now lives in coastal watershed counties or floodplain areas. Flooding is the most costly and prevalent natural disaster risk in the United States.

*History of the NFIP*

Major flood disasters in the United States in the 1920s and 1930s led to Federal efforts to protect lives and property from flooding. In 1936 Congress enacted the Flood Control Act to reduce the overall risk of flooding, but there were still significant at-risk communities that lacked insurance. In the 1950s, it became evident that private insurance companies could not provide flood insurance at an affordable rate. At that time, the only Federal relief available to flood survivors was disaster assistance through the Federal Disaster Assistance Program. In 1968, Congress established the NFIP to make affordable flood insurance available to the general public, and to protect communities from potential damage through floodplain management, which is the implementation of preventive measures to reduce flood damage.

When Tropical Storm Agnes struck the Eastern seaboard in 1972, many communities were either unaware of the serious flood risk they faced or were unwilling to take the necessary measures to protect residents of the floodplain. Very few of the communities affected by the storm had applied for participation in the NFIP. Even in participating communities, most owners of flood-prone property opted not to purchase flood insurance. Instead, they chose to rely on Federal disaster assistance to finance their recovery. As a result, Congress enacted the Flood Disaster Protection Act of 1973 to establish a mandatory flood insurance purchase requirement for structures located in identified Special Flood Hazard Areas (SFHAs) that have a federally backed mortgage.

The next year, Congress enacted the Disaster Relief Act, which contained several preparedness and mitigation provisions to reduce disaster-related losses. Later, the National Flood Insurance Reform Act of 1994 established the Flood Mitigation Assistance Program, which provided cost-shared funding for States and communities to develop mitigation plans and implement measures to reduce future flood damages.

The NFIP, with the certainty of the risk that it assumes, requires mitigation actions that aim to break the cycle of repeated disaster damage and reconstruction. To mitigate against repeated losses and damage to properties associated with flooding, Congress established two programs in the Flood Insurance Reform Act of 2004: the Severe Repetitive Loss program; and the Repetitive Flood Claims program.

Today, more than 21,000 communities in 56 States and territories participate in the NFIP, resulting in more than 5.6 million NFIP policies providing over $1.2 trillion in coverage. To directly respond to the flood-risk reduction needs of communities, FEMA has produced digital flood hazard data for more than 88 percent of the Nation's population. The NFIP floodplain management standards that each participating community is required to enact can reduce flood damages in newly constructed buildings by more than 80 percent.

Prior to 2003, more than 70 percent of FEMA's flood maps were at least 10 years old. These maps were developed using what is now outdated technology; and more importantly, many maps no longer accurately reflected current flood hazards. Over the last 8 years, Congress has provided over $1 billion to update and digitize our Nation's flood maps so we better understand the risks that our Nation faces from flooding. Since the start of FY2009, we have been implementing the Risk Mapping, Assessment, and Planning (Risk MAP) program, which not only addresses gaps in flood hazard data, but uses that updated data to form a solid foundation for risk assessment and floodplain management, and to provide State, local, and tribal governments with information needed to mitigate flood-related risks. Risk MAP is introducing new products and services extending beyond the traditional digital flood maps produced in Flood Map Modernization, including visual illustration of flood risk, analysis of the probability of flooding, economic consequences of flooding, and greater public engagement tools. FEMA is increasing its work with officials to help use flood risk data and tools to effectively communicate risk to citizens, and enable communities to enhance their mitigation plans.

This past fiscal year, the NFIP reduced potential flood losses by an estimated $1.6 billion and increased the number of flood insurance policies in effect by 47,992. FEMA also initiated 600 Risk MAP projects affecting 3,800 communities and addressed their highest priority engineering data needs, including coastal and levee areas.

As the Agency moves forward with our mapping program, we remain mindful of the challenges that flood mitigation efforts can pose for many families and communities. To that end, FEMA has used the flexibility it has under the NFIP to implement several important reforms that recognize these challenges. The most significant of these reforms are (1) the establishment of Scientific Resolution Panels and (2) the extension of eligibility for Preferred Risk Policies.

*Scientific Resolution Panels*

Flood hazards are constantly changing. For that reason, FEMA regularly updates Flood Insurance Rate Maps (FIRMs) to reflect those changes. However, when affected residents challenge revisions to the FIRMs with conflicting technical and scientific data, an independent third-party review of the information is available to ensure the FIRMs are accurate and credible.

FEMA's Scientific Resolution Panel (SRP) process, established in November 2010, provides an independent third party to work with communities to ensure the flood hazard data depicted on FIRMs is built collaboratively using the best science available. A community, tribe or political entity that has the authority to adopt and enforce floodplain ordinances for its jurisdiction can request that FEMA use the SRP when conflicting data are presented.

The SRP is composed of technical experts in engineering and scientific fields that are relevant to the creation of Flood Hazard Maps and Flood Insurance Studies.

Based on the scientific and technical data submitted by an NFIP community and FEMA, the SRP renders a written recommendation that FEMA either deny the community's data or incorporate it in part or in whole into the FIRM. For an appeal or protest to be incorporated, the community's data must satisfy the NFIP standards for flood hazard mapping. The SRP process is reflective of the value FEMA places on the importance of community collaboration to create accurate and credible flood maps.

*Preferred Risk Policy*

In 2003 FEMA began using appropriated funds to implement a nationwide initiative to update our flood maps. This effort has resulted in digital maps replacing the previous paper inventory, and in maps that more accurately reflect today's flood risk. As a result of mapping modernization, many buildings that previously were identified in low-risk areas have been mapped into high-risk Special Flood Hazard Areas (SFHAs). The flood risk is real, and those with federally backed mortgages find themselves subject to a statutory flood insurance purchase requirement. At the same time, mapping modernization has removed approximately the same number of structures from the SFHAs as it has added.

While the changes resulting from map modernization provide a more accurate reflection of a property and a community's flood risk, FEMA recognizes the financial hardship that a new SFHA designation may place on individuals. Consequently, effective January 1, 2011, FEMA began extending eligibility for its lowest-cost flood insurance policy—the Preferred Risk Policy (PRP)—for two additional policy years for individuals newly mapped into an SFHA. Previously, PRP eligibility was for 1 year only.

Extension of eligibility for the PRP should help to ease the financial burden on affected property owners in this difficult economic environment. With this change, property owners should also have adequate time to understand and plan for the financial implications of the newly communicated flood risk and the mandatory purchase requirement. Finally, this 2-year extension provides more time for the affected communities to upgrade or mitigate flood control structures to meet regulatory standards and reduce flood risks. This reduces the financial impact on residents and businesses in the long-term while making communities safer and stronger.

**NFIP Reform Working Group**

The NFIP has successfully reduced flood risks across the United States since its inception in 1968. Evidence of its success can be seen in the more than 21,000 participating communities, more than 5.6 million flood insurance policyholders, a modernized flood hazard data inventory, and a suite of incentives driving risk reduction across the Nation. Clearly, the program has improved the flood-resistance of existing and new construction through building standards, and has helped individuals and businesses recover more quickly from flooding through the insurance process.

However, after 42 years of program operation, concerns about the program remain; and after more than a decade of seeking input, identifying issues, and undergoing studies, FEMA believes that the time has come to undertake a critical review of the NFIP. As Members of this Committee and others in Congress consider NFIP reform, the Department of Homeland Security (DHS) and the Administration is prepared to assist those efforts as appropriate.

In 2009, I asked my staff to begin a comprehensive review of the NFIP. This review has involved three important phases designed to elicit policy recommendations and engage a broad range of stakeholders, including floodplain managers, emergency managers, lenders, the insurance industry, the environmental community, Federal agencies, and private nonprofit organizations. With so many diverse interests, stakeholder engagement has been a critical foundation of the review process.

Phase I of the NFIP review effort began in November 2009, with a listening session designed to capture and analyze stakeholder concerns and recommendations. The session included more than 200 participants and resulted in nearly 1,500 comments and recommendations from stakeholders.

Phase II began in March 2010, when FEMA formally established the NFIP Reform Working Group, tasked with identifying the guiding principles and criteria for potential proposals to reform the NFIP. This internal working group comprises a cross-section of FEMA's NFIP staff. As a means to conduct the analysis, FEMA chose a participatory policy analysis framework to guide the NFIP review effort. This Phase II effort incorporated the recommendations and themes resulting from the NFIP listening session and Web comments. The NFIP Reform Working Group concluded this phase in May 2010 and released a final report entitled "NFIP Reform: Phase II Report." The results of both Phases I and II are now available on FEMA's Web site.

As part of Phase III, which is ongoing, the NFIP Reform Working Group is reviewing a comprehensive body of work offering a critique of the NFIP, including reports by the Government Accountability Office, the Congressional Research Service and the DHS Office of the Inspector General; testimony before Congressional Committees; proceedings of various policy meetings; policy papers published by industry, advocacy groups and professional associations; and scholarly works. We have been reaching out to other Federal agencies as well. For example, we have solicited ideas from the Federal Interagency Floodplain Management Task Force, a group of 12 Federal agencies brought together to promote the health, safety, and welfare of the public by encouraging programs and policies that reduce flood losses and protect the environment.

Based on this research and stakeholder input, the NFIP Reform Working Group drafted a number of policy options for deliberation and public comment. In December 2010, FEMA held two public meetings and initiated a public comment period in order to solicit input from stakeholders on the policy options. Public input from these efforts served as a source for the refinement of the policy alternatives. Over 150 stakeholders attended the public meetings and we received 84 additional comments on specific policy options.

The NFIP Reform Working Group has identified several important issues that Congress may wish to address in the context of reform. They include, but are not limited to, actuarial soundness and program solvency, cost and affordability of flood insurance, mandatory purchase requirements, accuracy of mapping, and economic development and environmental protection. I would like to briefly address each of these issues.

*Actuarial Soundness and Program Solvency*

Current subsidies reflect the challenge to implementing the NFIP under the legislative mandate that flood insurance "is available on reasonable terms and conditions to persons who have need for such protection."[1] While the current program collects more than $3 billion in premium revenue annually, estimates indicate that an additional $1.5 billion in premium revenue is foregone due to the current subsidized rate policy.

This annual premium shortfall has at times required FEMA to use its statutory authority to borrow funds from the Treasury. These funds were used to pay flood damage claims to policyholders. Although payments have been made to reduce this obligation, $17.75 billion in debt remains and FEMA is unlikely to pay off its full debt, especially if it faces catastrophic loss years. The NFIP review effort is exploring fiscal soundness by analyzing inherent program subsidies and examining potential methods to further reduce the loss of life and property.

*Mandatory Purchase Requirement, Affordability, and Cost*

The cost of an NFIP policy and the affordability of flood insurance are topics of frequent discussion. In some communities, the introduction of updated flood hazard mapping results in new requirements for the purchase of NFIP policies. These premiums represent an unbudgeted and often unanticipated expense to property owners. To some, the insurance is unaffordable.

While FEMA has implemented some measures to address affordability concerns—including the Preferred Risk Policy—the program offers no means-based test that prices premium to income level. Affordability concerns are explored in the NFIP review effort with a variety of measures examined, ranging from credits and vouchers to high-deductible policies.

*Accuracy of Mapping*

When a new and more accurate map creates or expands a flood hazard area based on the latest science and information on flood risks, property owners newly added to this area, and thus required to purchase an NFIP policy, are understandably concerned. In some instances, this concern leads to questions about the scientific credibility of our mapping process. As noted above, we have created Scientific Resolution Panels to resolve these questions. And while FEMA is committed to working closely with communities to develop the most accurate flood maps possible, the current "in or out" nature of the SFHAs (one is either in an SFHA or not) has left the program with a perceived credibility problem, as there is no gradation of risk identified within a flood zone.

[1] 42 U.S.C. §4001(a).

*Economic Development and Environmental Protection*

The impact of the NFIP on economic development is another matter of debate among stakeholders. Areas prone to flooding may have unique resource advantages such as proximity to waterborne transport, as well as environmental or recreational value. However, these advantages, which may be revenue-positive for a property owner or community in the short-term, may become liabilities during a severe flooding event. As written by the Association of State Floodplain Managers: "[l]and use decisions are made by communities and tend to be based on local short-term economic factors in the form of community growth and resultant increases in the local tax base. These decisions often favor using floodplains for economic development, with the fact that the area is subject to flooding being a much lower priority in the decision."[2] The challenge of balancing economic development with floodplain management and risk reduction is explored in Phase III of the review effort.

Of course, these are not the only near-term issues that comprehensive NFIP reform should address. The NFIP Reform Working Group is examining other issues, which include certification of levees, properties that significantly drain the NFIP through repeated losses, subsidies, insurance ratings, building standards, and incentives and disincentives for mitigation.

**NFIP Reform Policy Alternatives**

In January 2011, FEMA's NFIP Reform Working Group completed the refinement of policy alternatives and began the policy evaluation phase. The Working Group is now in the analysis phase, with a third-party policy analysis organization performing both quantitative and qualitative analyses of the policy alternatives to identify each policy's strengths and weaknesses. The policy options are intentionally provocative and designed to represent the broadest range of policy options. The four policy alternatives moving forward to the evaluation phase each represent a unique policy theme. I would like to briefly discuss each policy option. The Administration has not taken a position on the preferred course of action for NFIP reform. These are currently draft proposals from the NFIP Reform Working Group. At this time, I view our role as helping to facilitate a needed conversation on identifying an effective path forward.

*Community-Based Insurance*

The NFIP uses two mechanisms for implementing the floodplain management, mapping, and insurance elements of the program. States and communities administer floodplain management requirements, including permitting and regulating land use. Communities also adopt Flood Insurance Rate Maps. However, the insurance element of the program is administered by "Write Your Own" insurance companies that participate in the program or by FEMA directly. Thus, while communities issue permits for construction in the floodplain, policyholders bear the cost of insuring against flood risk through the payment of an annual flood insurance premiums. Community land-use decisions do not account for the full cost of flood risk.

Based on what we have heard from stakeholders, we are exploring community-based flood insurance, whereby risk assessments would be performed on individual buildings and the insurance premium payment would be made by the community. As part of this option, the Federal Government would continue to back flood insurance contracts in exchange for the adoption and enforcement of minimum floodplain management standards and would provide an assessment and calculation of flood risk. The sum in dollars of the risk assessment for all buildings in the community would constitute the required premium. Incentives could be structured to encourage communities to implement flood mitigation measures in order to reduce their overall premium assessment.

*Privatization*

The NFIP was created in 1968, in part because of the absence of any substantive means, by insurance or otherwise, to mitigate the risk of flood hazards on the private insurance markets. Many hurdles stood in the way at the time: areas prone to flood hazards and the likelihood of flooding had not been identified; building practices and codes that mitigate the flood hazard were neither known nor enforced; and the financial risk of insuring properties with the potential for large catastrophic losses posed an unmanageable threat to the solvency of insurers.

In the more than 40 years since NFIP was created, the landscape has changed: flood risk has been digitally mapped and identified for 88 percent of the population; private and public sector modeling tools are available to model riverine and coastal

[2] Association of State Floodplain Managers whitepaper, "Critical Facilities and Flood Risk"; November 10, 2010.

flooding; the 21,000-plus communities participating in the NFIP have adopted building codes and practices to mitigate flooding; and the insurance and financial markets have developed a variety of means to spread risk from traditional reinsurance to more recent innovations of catastrophe bonds, risk markets, and financial derivatives.

Historically, the private insurance market has taken the position that flood is either uninsurable or prohibitively expensive. With that in mind, in January 2011, we brought in Chief Executives from several Write-Your-Own companies to discuss the optimal balance in flood coverage between the private and public sectors. This preliminary discussion served to initiate the conversation with the private flood industry to better understand what's possible in the future. We will be continuing the dialogue started in this session with a second meeting this fall.

*Federal Assistance*

Under the Federal assistance option, we are exploring a new framework for flood loss reduction in which the Federal Government would provide financial assistance through all Federal flood management programs only in communities in which specific flood mitigation and preparedness measures have been enacted. Failure of a community to enact such measures would result in a significant reduction in Federal flood-related disaster assistance, ineligibility for pre- and post-disaster grants for floodplain relocation, and could include limitations for flood control works.

In this option, the program could create a rating system similar to the NFIP's Community Rating System. The community rating could correspond to a cost-share structure for Federal flood disaster and mitigation programs. Communities with higher ratings could be given more favorable cost-share arrangements, whereas those with lesser rating could receive a significantly reduced cost-share.

*Optimization of Current NFIP Structure*

The NFIP optimization policy option outlines potential enhancements to the existing program to address programmatic weaknesses and current challenges while optimizing the existing achievements, strengths, and benefits of the program. The options for modification address many areas of the program such as Pre-FIRM subsidies, grandfathering, rating freedom, repetitive loss properties, coverage limits, mandatory purchase, assistance to low-income citizens, floodplain management standards, levees, flood hazard data, mitigation programs and grants, natural and beneficial functions of floodplains, and the NFIP debt.

These four policy proposals present a broad spectrum of the options available to enact comprehensive NFIP reform, but they are not the only ones. All policy options, however, acknowledge that even an extremely successful flood mitigation effort cannot eliminate flood risk. Flooding will continue to cause economic loss, which begs the question: Who should bear that loss? The NFIP Reform Working Group heard varying opinions on this matter, which are reflected in the four draft policy options. Economic loss from flood could be borne by local economies, charitable organizations, individuals who experience the flood loss, taxpayers through disaster relief and individual assistance programs, or the private insurance market.

The nature of the NFIP demands that it be looked at holistically rather than piecemeal; changing one facet impacts other aspects of the reform process. A successful outcome of NFIP reform will include a multiyear reauthorization of the NFIP to provide program stability, and a reform proposal that addresses short term issues; considers expert judgment and best practices; establishes the long term program direction; and incorporates the incremental reforms necessary to achieve that target State.

**Conclusion**

The NFIP helps communities increase their resilience to disaster through risk analysis, risk reduction, and risk insurance. It also helps individual citizens recover more quickly from the economic impacts of flood events, while providing a mechanism to reduce exposure to flooding through compliance with building standards and encouraging sound land-use decisions.

While the NFIP has been an extremely successful program through its 42 years of existence, we know we can do better. Through the NFIP Reform Working Group, we have engaged stakeholders of various disciplines from across the Nation to help us guide the NFIP review effort. We look forward to sharing the findings from this ongoing effort with you as we continue to work together to ensure a strong NFIP.

Thank you again for the opportunity to appear before you today. I am happy to answer any questions you may have.

**RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM W. CRAIG FUGATE**

**Q.1.** The mandatory purchase requirement is one important method for communicating risk to homeowners. What coordination are you having with the banking regulators to ensure that banks notify borrowers of their flood risk and maintaining their coverage?

**A.1.** The enforcement of the mandatory flood insurance purchase requirements is the responsibility of the Federal regulatory agencies, and FEMA has taken a variety of measures to assist the regulators in this responsibility.

- The Mandatory Flood Insurance Purchase Guidelines, compiled and published by FEMA, has served as a valuable resource to regulators, lenders, and consumers for over 25 years.
- FEMA regularly consults with the individual regulatory agencies, Government Sponsored Enterprises, Federal agency lenders, the Federal Financial Institutions Examination Council (FFIEC), and lender trade associations. This includes resolution of specific problems, and mutual review of documents, guidance, and regulations.
- FEMA operates a telephone response center that answers questions from the public on all matters relating to the NFIP, including the details of the mandatory purchase requirements, where they apply, why they are important, and how to satisfactorily comply with them.
- FloodSmart, the NFIP's marketing and information service, besides producing educational and informational materials for lenders and the public, provides a Web site for the public to submit inquiries to the NFIP. A large number of these inquiries are from lenders, insurance agents, and borrowers asking about all aspects of the mandatory purchase requirements.
- FEMA conducts lender training both instructor-led and via webinar to ensure that lenders understand the flood insurance purchase requirements and the resources available to them in carrying out their responsibilities.
- FEMA has recently established a Lender Work Group, composed of lenders, insurance agents, Federal regulators, flood zone determination companies, and FEMA to identify the obstacles to effective enforcement of the mandatory purchase requirements.

The requirement to purchase flood insurance for certain high-risk properties is a mandate that by statute is implemented by the Federal lending regulators through the lenders they oversee to the homeowner applying for a mortgage. FEMA can, and does, assist in this implementation process, but the FEMA role must necessarily be one of providing technical guidance, educational materials, informational brochures, and technological support. FEMA has done all that and will continue to do so.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM W. CRAIG FUGATE**

**Q.1.** Administrator Fugate, this year has proven to be one of the worst in recent memory for disastrous floods. The Army Corps of Engineers has had to take the extraordinary action of flooding certain communities to save others. Many of the communities that have been flooded were located behind levees, flood walls, and dams. As a result, many people living in these areas did not have flood insurance.

Please comment on the risks that exist for communities that are located behind levees, flood walls, and dams and whether there should there be a mandatory purchase requirement for people living in these residual risk areas.

**A.1.** FEMA supports the mandatory purchase of flood insurance for areas behind structural flood protection systems. These areas represent a higher risk than standard X zones, and the structural flood prevention systems provide a false sense of security to those who reside there. FEMA suggests that there be further study before dams are included in this requirement. There are existing dam safety programs that deal with mapping of dam failures. The nature of the risk below dams is different from the risk behind levees. Dams serve many purposes besides flood control and the area below a dam would not necessarily be in the natural 100-year floodplain, if the dam were not there. The term "residual risk area" is not clear. FEMA would characterize the issue as whether areas would be in the SFHA were it not for the existence of a levee or other structural flood protection system. This area describes the "natural floodplain."

**Q.2.** Nearly 50 percent of the people who are required to have flood insurance do not actually purchase flood insurance. This low participation rate exists in spite of the fact that there is a mandatory purchase requirement for federally backed mortgages. The GAO, among others, has pointed out that both FEMA and banks do a poor job of enforcing the flood insurance requirement.

What steps has FEMA taken to bolster its enforcement of the participation requirement?

Does FEMA need additional tools or does Congress need to take specific action to ensure that banks are doing their job, and, if so, what action does FEMA recommend?

**A.2.** The enforcement of the mandatory flood insurance purchase requirements is the responsibility of the Federal regulatory agencies, and FEMA has taken a variety of measures to assist the regulators in this responsibility.

- The Mandatory Flood Insurance Purchase Guidelines, compiled and published by FEMA, has served as a valuable resource to regulators, lenders, and consumers for over 25 years.
- FEMA regularly consults with the individual regulatory agencies, Government Sponsored Enterprises, Federal agency lenders, the Federal Financial Institutions Examination Council (FFIEC), and lender trade associations. These discussions include resolution of specific problems, as well as mutual review of documents, guidance, and regulations.

- FEMA operates a telephone response center that answers questions from the public on all matters relating to the NFIP, including the details of the mandatory purchase requirements, where they apply, why they are important, and how to satisfactorily comply with them.
- FloodSmart, the NFIP's marketing and information service, besides producing educational and informational materials for lenders and the public, provides a Web site for the public to submit inquiries to the NFIP. A large number of these inquiries are from lenders, insurance agents, and borrowers asking about all aspects of the mandatory purchase requirements.
- FEMA conducts lender training both instructor-led and via webinar to ensure that lenders understand the flood insurance purchase requirements and the resources available to them in carrying out their responsibilities.
- FEMA has recently established a Lender Work Group, composed of lenders, insurance agents, Federal regulators, flood zone determination companies, and FEMA to identify the obstacles to effective enforcement of the mandatory purchase requirements.

The requirement to purchase flood insurance for certain high-risk properties is a mandate that by statute is implemented by the Federal lending regulators through the lenders they oversee to the homeowner applying for a mortgage. FEMA can, and does, assist in this implementation process, but the FEMA role must necessarily be one of providing technical guidance, educational materials, informational brochures, and technological support. FEMA has done all that and will continue to do so.

As discussed above, the purchase of flood insurance on certain high-risk properties is implemented through the Federal lending regulators to the lenders. We are not in a position to make specific recommendations regarding the policing of banks penalties against lenders who show a pattern or practice of noncompliance with flood insurance statutes and regulations.

**Q.3.** Administrator Fugate, FEMA has adopted a new policy for mapping provisionally accredited levees. Previously, FEMA did not consider nonaccredited levees when developing new floodplain maps. This increased the flood insurance rates paid by communities located behind nonaccredited levees. Recently, FEMA has said that it will begin considering certain, provisionally accredited levees in flood maps.

Please discuss FEMA's change in policy and how FEMA plans to determine the level of protection provided by provisionally accredited levees.

How will FEMA ensure that these levees will be brought up to the required protective levels within a reasonable time?

**A.3.** FEMA is currently developing a new levee policy that addresses the analysis and mapping of nonaccredited levees. This new policy will be finalized in the next few months. The new policy does not impact provisionally accredited levees or the modeling and mapping of accredited levees. The provisional accreditation is a designation used for levees that are not currently accredited, but are expected to become accredited in an agreed upon timeframe once appropriate documentation is provided.

The responsibility for ensuring that these levees will be brought up to the required protective levels is beyond FEMA's purview and expertise. FEMA's responsibility lies wholly in adequately reflecting the known flood hazard in the vicinity of the levees, regardless of the level of protection provided by the structure. Through FEMA's Risk MAP program and additional engagement with the impacted communities, FEMA will help the community to increase flood risk awareness and take additional steps toward action to reduce risk. These mitigation steps can come in many forms, including structural means and also options like relocation, elevation, *etc.*

**Q.4.** There has been a lot of focus on the Map Modernization efforts that FEMA has undertaken over the past several years. I understand that you have worked through many of the initial issues you encountered in updating the maps and introducing them into the communities. However, there are still those who wish to delay the implementation of the maps.

I would like to hear about the efforts made to involve the communities in the process. I understand that there is an appeals process if communities do not believe that FEMA has used the most appropriate data or their data is incorrect, but how closely does FEMA work with the community as it develops and updates the maps? That is to say, is it a collaborative process?

**A.4.** Community involvement was an important component of Map Modernization. However, lessons learned in Map Modernization have helped to inform how community engagement should be improved, and these improvements have been incorporated into the vision for Risk Mapping, Assessment, and Planning (Risk MAP).

During Map Modernization, communities were engaged in the mapping process mainly through planning, reviewing, and providing comments on preliminary Flood Insurance Rate Maps (FIRMs) and Flood Insurance Study (FIS) reports. In an effort to obtain all relevant information and ensure accurate study results, FEMA usually held two meetings for community officials and other interested parties: a Scoping Meeting and a Final Meeting/Open House.

The initial coordination activities between FEMA and individual communities included an evaluation of the needs and the available funding to establish the scope of the study. During this process, community officials usually met with FEMA and other agencies at a Scoping Meeting to determine the appropriate areas of concentration for the mapping project. Once the flood study was complete, which may have taken several years, the community was sent copies of the preliminary FIRM and FIS report to review. After a 30-day review and comment period, a Final Meeting and public Open House was scheduled by FEMA's Regional Office staff and community officials to review the preliminary FIRM and FIS. The Final Meeting was usually held with community officials only to review the FIRMs and FIS; the Open House was usually open to the public. They were often held on the same day.

Unless significant technical concerns were raised before or during the Final Meeting and Open House meeting, FEMA would then begin a 90-day appeal period, which only applied when Base Flood Elevations (BFEs) were either revised or newly proposed. BFE notices were published in a local newspaper on two different dates, usually within a week of each other, and a notice was also published in the Federal Register. The 90-day appeal period began on the date of the second publication in the local newspaper. During the appeal period, property owners and other citizens in the community would have the opportunity to submit technical and/or scientific data to support an appeal of the proposed BFEs. When the 90-day period was complete and any appeals were resolved, the new FIRM and FIS report would move towards finalization.

Starting in 2010, FEMA also implemented Scientific Review Panels (SRPs) for communities and other stakeholders to use if FEMA's resolution of an appeal was not satisfactory. To be considered for the SRP, the data must be submitted during the 90-day appeal period, resulting in different flood hazards than those proposed by FEMA. Also, the community must consult with FEMA for a minimum of 60 days following the end of the appeal period. If activated, the SRP consists of a panel of five independent reviewers from the scientific and engineering communities. This panel reviews the engineering data, the preliminary FIRM and FIS, and any appeal presented by the community, then provides a written report with its decision and rationale to FEMA and the community within 150 days. The SRP's decision will become the recommendation to the FEMA Administrator, who will make the final determination. The SRP process is managed by the National Institute of Building Sciences, a nonprofit organization independent of FEMA.

FEMA has implemented other changes as well. Community engagement is critical to Risk MAP's success. Through targeted, consistent outreach throughout a project, FEMA will work to make it easier for people and communities to reduce their vulnerability to flood risk. Some of the lessons learned in Map Modernization that have been addressed in Risk MAP are:

- Map Modernization Scoping Meetings were often held after FEMA had already decided on a mapping project scope. If new information was uncovered at the Scoping Meeting, it may not have been able to be incorporated into the mapping project since the project had already been funded. For Risk MAP, FEMA has completely revised the Scoping Process (now referred to as Discovery) to include better coordination with communities watershed-wide, to broaden the types of stakeholders that are engaged, and to begin discussions about flood risk earlier in the process. Risk MAP's Discovery Process will include coordination with communities on the project scope to a much larger extent than in the past. FEMA will not walk into a Discovery Meeting knowing the scope of the project. In fact, if it is determined after Discovery that a project is unwarranted, a project will not be initiated. If a project is warranted, FEMA will work with communities to determine and finalize the scope, and those decisions will be documented in a project charter or memorandum of understanding that all parties will sign.

- Communities were often not engaged thoroughly in the time between the Scoping Meeting and the release of the preliminary FIRM and FIS, which, for some Map Modernization studies, was a period of several years. The long period of time and other issues (for instance, staff turnover at the community) often resulted in surprise and confusion once the preliminary FIRMs and FIS were issued. Also, during the time the preliminary FIRM and FIS were being prepared, changes to the scope may have occurred. If these scope changes were not communicated to the communities, the preliminary FIRMs, once issued, resulted in backlash from communities. In Risk MAP, communities will be engaged throughout the project timeline, including while the data is being collected and the flood risk products are being made. Changes to scope will be coordinated with communities. Risk MAP projects may also include a Flood Risk Review Meeting at the Regional Office's discretion. Prior to the release of the preliminary FIRM and FIS, this meeting is held after the engineering data has resulted in draft flood risk assessments and other flood risk visualizations, such as depth and velocity grids, a map showing areas of mitigation interest, and other products that have not been included in Map Modernization.
- The products of Map Modernization (FIRMs and FIS reports) are regulatory products that are used in part to determine flood insurance purchase requirements. This often leads to a discussion between homeowners, communities, and FEMA regarding who is "in or out" of the flood zone. Discussions regarding the consequences of flooding to a community, flood depths and velocities, evacuation routing, warning systems, mitigation planning, and reducing flood risk are lost in this often contentious debate. For Risk MAP studies, a much more robust offering of flood risk products and assistance to communities will be available. In addition, Risk MAP projects will include a Resilience Meeting, which is a meeting that occurs before the preliminary FIRM and FIS are released and is focused on building local capacity for implementing priority mitigation activities within a watershed. Discussions will focus on understanding the flood risk that exists in the watershed, planning for that risk, and communicating that risk to citizens. While "in/out" discussions will likely always exist, FEMA is attempting to refocus the discussion on mitigating and communicating the flood risk.
- Currently, appeal periods are only initiated when BFEs are revised or newly proposed. No appeal period is initiated when a flood zone without BFEs is newly mapped or revised, or when flood zone delineations change based on new topographical information and become larger or smaller. This has resulted in backlash from communities that did not receive an official appeal period and felt that they were therefore not as integral to the mapping process as communities who received official appeal periods. A new interpretation of the regulatory underpinnings of the National Flood Insurance Program will result in a revised policy to provide the same due process currently provided to changes in BFE determinations to other

changes in flood hazard information on the FIRM, including the addition/modification of approximate floodplain boundaries and the regulatory floodway, and the redelineation of existing detailed floodplain boundaries.

The Risk MAP community engagement approach has several guiding principles, which, together with the specific changes described above, will help to enhance FEMA's community engagement strategy:

- Engage communities early and often.
- Agree upon and document project outcomes and responsibilities.
- Coordinate with other programs operating within the same community.
- Engage associations to provide a third-party perspective.
- Leverage local media and use language that people understand.

**Q.5.** A key issue underlying the current program is the lack of information provided to citizens regarding their true risks of flooding. While subsidized rates provide a certain sense of false security, the lack of easily understandable information provided to individuals living in high risk areas is another contributing factor.

Please discuss FEMA's efforts in introducing the new maps and how it may differ today from when FEMA first began introducing the new maps. Please also discuss how your efforts ensure that individuals get the information they need to truly understand their risk.

**A.5.** Risk Mapping, Assessment, and Planning (Risk MAP) provides communities with flood information and tools they can use to enhance their mitigation plans and take action to better protect their citizens. Through more precise flood mapping products, risk assessment tools, and planning and outreach support, Risk MAP strengthens local ability to make informed decisions about reducing risk.

In an effort to ensure the individuals get the information they need to truly understand their risk, Risk MAP focuses on products and services beyond the traditional Flood Insurance Rate Map (FIRM) and works with officials to help put flood risk data and assessment tools to use, effectively communicating risk to citizens and enabling communities to enhance their mitigation plans and actions. For example, FEMA will produce Flood Depth and Analysis Grids, and Flood Risk Assessments. Flood Depth and Analysis Grids help communities better understand their flood hazard and risk in mapped floodplains since it displays a depth of flooding for specific events. In addition, Flood Risk Assessments will be provided to help guide community mitigation efforts by highlighting areas where risk reduction actions may produce the highest return on investment.

FEMA delivers these products and services in Risk MAP through a more robust community engagement strategy. The community engagement approach in Risk MAP outlines a series of important "touchpoints" that occur during each project from the time FEMA plans for a project through a series of community meeting and any necessary map updates. The following provides the guiding principles being used for the community engagement approach:

- Engage communities early and often.
- Agree upon and document project outcomes and responsibilities.
- Coordinate with other programs operating within the same community.
- Engage associations to provide a third-party perspective.
- Leverage local media and use language that people understand.

Community engagement is critical to Risk MAP's success. Through targeted, consistent outreach throughout the Risk MAP timeline, FEMA works to make it easier for people and communities to reduce their vulnerability to risk.

**Q.6.** The Flood Insurance program provides critical assistance to 5.5 million families and businesses. It also provides a framework of responsible floodplain management, requiring safer, more environmentally sound development that limits Americans' flood risk.

Given that many communities may be hesitant to take more drastic measures to mitigate flood risk due to economic development concerns, what steps does FEMA take to ensure that communities participating in the program are active partners rather than just partners on paper?

**A.6.** FEMA provides extensive technical assistance to 21,500 NFIP participating communities. FEMA places a significant emphasis on providing training to local floodplain managers. During these training sessions, communities are encouraged to adopt and enforce higher floodplain management standards that go above and beyond the minimum NFIP criteria. Information is provided on the overall flood loss reduction benefits, as well as the significant flood insurance discounts associated with safer construction. FEMA and its State partners conduct hundreds of these training sessions every year. FEMA partners with the Association of State Floodplain Managers (ASFPM) and its 14,000 members in an effort to communicate and outreach to NFIP communities. FEMA provides funding for ASFPM's annual national conference where approximately 1,500 State and local floodplain managers attend. FEMA also provides funding for the Associations Certified Floodplain Manager's (CFM) program whereby local officials meet minimum standards and receive the CFM credential.

We are pleased to see that many communities participating in the National Flood Insurance Program are acutely aware of their risk to flooding and choose to voluntarily implement floodplain management practices that exceed Federal minimum standards. These communities implement floodplain management programs designed to address their unique local flooding characteristics. The National Flood Insurance Program's Community Rating System (CRS) recognizes communities that implement these higher standards and provides discounts on the cost of flood insurance, commensurate with the reduced risk. Flood insurance premium discounts are provided in 5 percent increments to policyholders according to a define program of 19 floodplain management activities.

The CRS is a voluntary program that has been in place since 1990. Eleven hundred and sixty four communities have joined the CRS. Interest in the CRS is steadily growing with approximately 30 new communities joining each year. Sixty seven percent of all flood insurance policies are located in communities that participate in the CRS.

Additionally, FEMA provides financial assistance to help communities mitigate. FEMA has five Hazard Mitigation Assistance (HMA) grant programs that FEMA can utilize to provide funds to State and local communities to reduce the loss of life and property from future disasters. For example, the Hazard Mitigation Grant Program (HMGP) provides grants to States and local governments to implement long-term hazard mitigation measures after a major disaster declaration. The purpose of the HMGP is to reduce the loss of life and property due to natural disasters and to enable mitigation measures to be implemented during the immediate recovery from a disaster. FEMA's Hazard Mitigation Assistance (HMA) grant programs provide funds to assist States and communities implement measures that reduce or eliminate the long-term risk of flood damage to buildings, manufactured homes, and other structures.

The Pre-Disaster Mitigation Program is a nationally competitive program that provides funds to States and communities, including Tribal governments, for hazard mitigation planning and implementation of mitigation projects prior to a disaster event. The PDM Program provides Applicants with an opportunity to raise risk awareness and reduce disaster losses through cost effective hazard mitigation activities.

The effectiveness of FEMA's mitigation projects has been repeatedly confirmed, such as in two independent studies commissioned by Congress. One study, conducted by the National Institute of Building Sciences in 2005 reported that for every $1 spent on various mitigation activities, $4 in response and recovery costs are saved. In September 2007, the Congressional Budget Office evaluated the Pre-Disaster Mitigation Program and found that for every $1 spent on mitigation projects, losses from future disasters are reduced by $3. FEMA's mitigation programs have allowed FEMA to work with its State and local partners to reduce the possibility of property damage, personal and commercial hardship, as well as long lasting monetary burdens.

**Q.7.** The GAO has highlighted that in its "ongoing work examining FEMA's management of the NFIP . . . FEMA does not have an effective system to manage flood insurance policy and claims data, although investing roughly 7 years and $40 million on a new system whose development has been halted."

Why were the investments made in these critical operational systems subsequently halted?

What steps has FEMA taken since this time to put in place a more effective management system?

**A.7.** At a TechStat session held on November 23, 2010, OMB and DHS reviewed the National Flood Insurance Program Information Technology System and Services (NFIP ITSS) and identified areas of concern, including questions regarding system functionality and documentation completeness. DHS elected to terminate the investment amid concerns that overall software quality could not be validated and that an independent evaluation indicated that the user needs may not be met.

FEMA developed a path forward to improve the management and governance, and the plan was presented to the DHS CIO, DHS OIG, and GAO. This path forward revisited the Executive Steering Committee (ESC) membership and added a Chairman and Deputy Chairman. The ESC Charter was revised as well. A Program Management office was established as part of the FEMA Office of the Chief Information Officer, and a Program Executive and Deputy Program Manager have been hired.

**Q.8.** Administrator Fugate, it is my understanding that FEMA has created a new category of "grandfathered properties" for homes that have been mapped into riskier areas. These grandfathered properties enjoy taxpayer-subsidized flood insurance rates.

Please discuss how the newly "grandfathered" category works.

Is it a permanent category?

If not, please detail how these "grandfathered" properties will move towards rates that more accurately reflect their actual risk?

**A.8.** Under the law, statutory grandfathering allows taxpayer subsidized premiums only to insurance policies covering buildings constructed before a community adopts its initial Flood Insurance Rate Map (FIRM) upon entry in the Regular Program of the National Flood Insurance Program (NFIP).

Under the law, Post-FIRM properties must be actuarially rated. Because Pre-FIRM buildings were constructed before the existence of NFIP building requirements, the subsidized premiums, while discounted, can often be higher than Post-FIRM actuarially rated policies. Thus, a Pre-FIRM policy may be actuarially rated if the actuarial premium for the specific type of building is less than the subsidized premium. However, each class of Post-FIRM rating must be actuarially sound under the law.

Administrative grandfathering is distinct from statutory grandfathering. Administrative grandfathering involves creating a class of actuarially rated policies that share common traits. Under the rules of the NFIP, administrative grandfathering provides an option to use the flood zone of Base Flood Elevation (BFE) from a previous Flood Insurance Rate Map (FIRM) after a map revision if using the older rating data is more favorable than using the data from the current FIRM. This type of grandfathering has been employed since the early 1980s. FEMA has implemented no program that increases taxpayer-subsidized flood insurance rates, which would be illegal.

Under administrative grandfathering rules, regardless of the application date, buildings constructed after a community's initial entry into the Regular Program of the NFIP may be insured based on rating that uses the flood zone and BFE in effect on the date of construction if the older data allows a more favorable premium than the current FIRM data. Also under administrative grandfathering rules, any building may continue to be insured (renewed) based on rating that uses the flood zone and/or BFE used to rate the initial application, if this data is more favorable than a subsequent map revision. In order to consider a non-SFHA flood zone in the rating using the administrative grandfathering rules, buildings constructed before a community's initial entry into the NFIP (when no FIRM was effective) needed to be insured by an application submitted before the building was newly mapped into the SFHA.

In the past, the NFIP's Preferred Risk Policy (PRP) was only available to properties actually determined to be outside of the Special Flood Hazard Area (SFHA) on the date of application. The PRP cannot be grandfathered. Older buildings constructed before the community's first FIRM needed to be insured under the PRP before a property became newly mapped into an SFHA. Upon renewal after the building was newly mapped to an SFHA, the property remained eligible for administrative grandfathering to the zone reflected on the PRP (an X zone). While a standard X-zone rate is higher than a PRP, it is typically lower than the premium calculation using the SFHA. A standard X-zone rated policy, while more expensive than a PRP, is less expensive than a subsidized policy offered under statutory grandfathering.

On January 1, 2011, FEMA implemented the 2-Year PRP Eligibility Extension, which allows the application to be rated under the PRP for up to 2 years after a building is newly mapped into the SFHA. A slight increase in premiums to the entire PRP class nationwide made this extension actuarially sound. This extension also allows older building to be eligible for administrative grandfathering when the policy is converted from a PRP to a standard rated policy. If standard X-zone rating under administrative grandfathering is less expensive than the premiums available through statutory grandfathering, those property owners who purchased a PRP within 2 years of map revision will be eligible for the standard X-zone rating.

This is not a permanent category because individual policies qualify for this further PRP eligibility for only 2 years. Any further extension of PRP eligibility (such as a longer duration than 2 years) would need to be offset by a corresponding increase in the PRP premium. Thus, any further extension of PRP eligibility to those currently ineligible due to a higher risk of flooding will lead over time what is called "adverse selection." As more and more high risk properties are added to the class, the premiums correspondingly rise. As the premiums rise, those at lower risk drop out. We have seen this occur with administrative grandfathering applied to standard-rated policies. Currently, almost all standard X-Zone rated policies are nonbasement properties that were once considered outside of the SFHA, but are now mapped in the SFHA, or repetitive loss properties. The premiums for a standard X-Zone policy are typically three to four times higher than the PRP. This residual book of business, as a class, is actuarially sound.

---

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM W. CRAIG FUGATE**

**Q.1.** You have indicated that the current budget will not allow FEMA to meet its Risk MAP objective of ensuring that 80 percent of the Nation's flood hazard data are new, updated, or deemed still valid by 2014.

Based on the funding rate in the FY2012 request, when will FEMA meet its goal?

What are the implications of delay?

**A.1.** FEMA will meet the goal of ensuring that 80 percent of the Nation's flood hazard data are new, update or deemed still valid by 2020. FEMA will defer the total number of Risk MAP project starts in FY12 and future years. We evaluated the proposed funding level during the development of the budget justification for FY12, assuming that future year funding would be at the same level (adjusted for inflation) as FY12. FEMA used a life cycle cost model to predict the extended time to 2020. The assumptions within the model include: the prioritization strategy established for Risk MAP, program fixed and variable costs, currently identified flood hazard updated needs, an estimate of additional flood hazard data that will be validated during the current national assessment, and an estimate of how quickly flood hazard data that is currently valid will be invalidated by physical, climatological and engineering methodology changes. While this slower pace of production impacts the currency of the Flood Insurance Rate Maps, we believe that this pace is justified given the current Federal budget constraints.

**Q.2.** Until last year, when FEMA established new standards to ensure appropriate topographical data in mapping, the U.S. Geographical Survey's topographical data set was often the default for updating flood maps. GAO reported last year (FEMA Flood Maps, GAO-11-17) that despite the fact that it is on average 35 years old, USGS's data had been used for mapping in many high risk areas because it was less costly.

Can you describe the data FEMA will rely on going forward and the efforts you are undertaking to ensure that appropriate data (not just the cheapest) is used to update flood maps?

**A.2.** FEMA intends to obtain high-quality elevation data. FEMA will manage elevation data used for Risk MAP as part of its Engineering Library system that houses all the supporting data used for Risk MAP. FEMA will also work with USGS to integrate Risk MAP elevation data with other national elevation data resources to make the data more widely available and easier to use.

High-quality elevation data will not only increase the quality of the flood hazard maps but will also aid in developing risk assessment data, assist in developing actionable mitigation plans, and improve credibility, all of which help to achieve the overall mission of reducing the impact of disasters on lives and property. Furthermore, the data will result in a substantial increase in the public's awareness of risk—one of Risk MAP's operational goals—which, in turn, drives citizens to take actions toward mitigating risks. More information on FEMA's elevation data strategy and collaboration with other Federal agencies can be found in FEMA's "Risk Mapping, Assessment, and Planning (Risk MAP)—National Digital Elevation Acquisition and Utilization Plan for Floodplain Mapping", dated July 2010, available at *http://www.fema.gov/plan/prevent/fhm/rm_main.shtm#4.*

FEMA specifications for elevation data are aligned with the USGS to maximize partnerships and data utility. The specifications for FEMA's highest risk areas are the same as USGS accuracy specs. The new standard establishes minimum accuracy requirements for all risk levels, that vary based on the risk and terrain. "Best available data" is no longer acceptable if it does not meet the minimum standard.

**Q.3.** FEMA has indicated it will spend $80 million between 2010 and 2013 to secure new topographical data—something it has not done in the past due to its concerns about cost.

Does FEMA plan to maintain that commitment?

Who is (and who should be) responsible for securing the appropriate data for each map update—FEMA or local governments?

What other funding and technical assistance, if any, are provided to States and communities to help them develop their own capacity to assist in mapping updates?

**A.3.** In FY2011, FEMA plans to spend $20 million to acquire elevation data. High-quality elevation data form the foundation for increasing the quality of the flood maps, aid in developing risk assessment data, and assist in developing actionable mitigation plans based on improved hazard data. The lower funding requests in future years outlined in the President's Budget will spread the elevation data investment over a longer period of time. FEMA is committed to high quality elevation data and still believes it to be a prerequisite for any updated flood hazard analysis.

The National Flood Insurance Program is a partnership with more than 21,500 communities across the country. While FEMA makes the significant investments, communities often have additional data to contribute (through their Planning Departments, Watershed Councils, Stormwater Agencies, *etc.*). So while FEMA does not require local contributions of data, we encourage collaboration with the local agencies that have the expertise and supporting data.

In recent years, the Appropriations Committees have directed FEMA to prioritize map production funding for those partners that provide a cash match. While this has been successful, it is not the sole basis for funding future studies.

FEMA has a Cooperating Technical Partners (CTP) program. The CTP Program allows communities, regional agencies, State agencies, universities, and Tribal Nations that have the interest and capability to become active partners in the FEMA Flood Hazard Mapping program. Eligible regional agencies include: watershed management and flood control districts, regional planning councils, councils of governments, and regional offices of State agencies.

Specifically, our partners benefit because:

- The data used for local permitting and planning is also the basis for the NFIP map, facilitating more efficient floodplain management.
- The CTP Program provides the opportunity to interject a tailored, local focus into a national Program; thus, where unique conditions may exist, the tailored approaches to flood hazard identification may be taken.

- The partnership mechanism provides the opportunity to pool resources and extend the productivity of limited public funds.

CTP Program-related activities may be funded based on FEMA's priority of mapping needs and the availability of FEMA funds for mapping. If FEMA funds are available, the Partner will receive funds through a Cooperative Agreement. Each FEMA Regional Office will determine how much of its annual mapping budget will be allocated to mapping activities under the CTP Program. The Cooperative Agreements awarded for mapping activities under the CTP Program are intended to supplement, not supplant, ongoing mapping efforts by a Partner, whether it be a community, regional agency, or State agency.

**Q.4.** Mapping is a collaborative effort and FEMA relies on Federal and nonfederal partners.

Please comment on how you are working with other Federal agencies, such as USGS, NOAA, and the Army Corps on mapping.

What data and assets are these agencies providing to support mapping and are these complementary efforts being properly funded?

Can you comment on how FEMA is working with the private sector and how it is using new technology to improve the accuracy and usability of maps?

**A.4.** FEMA has close working relationships with an array of Federal agencies, including NOAA, the U.S. Army Corps of Engineers, and the USGS. While we each have our own statutory missions, there are clear areas of congruence as we better understand flood risk in the Nation. Specific attention is given to how we can leverage investments across the agencies and not duplicate spending. For the USGS, this is done through a relationship (documented in an MOU) at Headquarters. For the USACE, this is done through relationships at Headquarters as well as Region to District collaboration. The USACE efforts are enhanced by FEMA's participation with the Silver Jackets initiative where States convene all the Federal agencies in their area to focus on flood risk management. Over the past year, FEMA has been engaged in a joint Task Force with the USACE and the Office of Management and Budget to specifically address levee mapping concerns across the country. NOAA coordination is done with the specific offices.

FEMA collaborates with the USGS on elevation data and hydrology. FEMA collaborates with NOAA's National Weather Service for river gage data and the Ocean Service for coastal gage data, the Coastal Services Center on data sets and community outreach, and the Climate Service on climate change data. FEMA also coordinates with Geodetic Survey for geodetic control and survey standards and best practices.

The majority of flood hazard engineering, production, map finishing, and delivery is done by private sector contractors with oversight from FEMA SMEs. These mapping partners are adept in Geographic Information System (GIS) technologies, which are used throughout the mapping process.

FEMA provides flood hazard data that the private sector incorporates into tools they develop. A good example of this is the Web Map Service (WMS) of the National Flood Hazard Layer that can be viewed with Google Earth or any other application that uses this protocol. Mobile applications have recently been developed by private industry that tie our flood data from this service into devices such as iPhones and Android phones.

FEMA works closely with ESRI, a major GIS software and services provider, through the Enterprise License agreement managed by the Geospatial Management Office. ESRI conferences are also important events to keep up with current trends and private sector offerings from the geospatial sciences sector.

FEMA's emphasis has been to focus on data, and more recently, data services. The emphasis on data services allows private sector to add value to FEMA data in making it available to the public while reducing cost to FEMA for distribution of this data. We are currently working on a strategy to more directly address external solution providers to help them better communicate risk to end users with our data. This includes not just traditional flood data, but other Risk MAP data as well.

**Q.5.** There have been legislative efforts to delay the adoption of new maps in order to forestall the designation of Special Flood Hazard Areas.

What are the consequences to the program and society if we delay the initiation of map updates and the adoption of new maps?

**A.5.** FEMA has a statutory requirement to expeditiously identify and disseminate information regarding flood prone areas in the Nation (42 USC 4002(b2)). Timely and accurate flood hazard information provides the basis of sound decision making in communities and with individuals. Over the past 7 years, the updating of flood hazard maps has shown changes in the Special Flood Hazard Areas. These changes are driven by changes in the built environment throughout the watershed and by additional data regarding storms and water flow. Over the past 7 years, on average as many structures have been removed from the Special Flood Hazard Areas as have been placed in them through the updated analyses. These shifts continue to make the maps current and ensure their accuracy. Further, the structures at the greatest risk are identified and the public can take the appropriate actions to mitigate or buy down their risk through flood insurance.

Delaying maps means that FEMA, in some instances, has analyses that demonstrate that some homeowners currently required to buy flood insurance should not have that mandatory requirement—thus their insurance, should they choose to keep it, would be significantly cheaper. In other instances, FEMA has analyses that clearly show an area at high risk, yet that information is withheld. In this latter instance, homeowners may be unaware of their risk (most homeowners become aware of their status from their banks after the Flood Insurance Rate Map goes into effect). If an intervening flood event occurs in the community, many of those who should have had flood insurance will not. In the absence of flood insurance, very limited resources are available for individuals to recover.

**Q.6.** In response to a request from 29 senators, you announced in March that FEMA would temporarily withhold issuing Letters of Final Determination for communities whose levees do not meet accreditation requirements in order to allow time for FEMA to develop new methodologies that will more accurately reflect the flood risk in areas impacted by these levees.

When will FEMA complete the development of these methodologies? Can you provide an estimate for the cost of developing and applying these new methodologies? How will FEMA pay for these efforts without compromising other mapping objectives?

How will these methodologies be implemented in communities where Final Determinations have already been issued?

**A.6.** Regarding the timeline, see above. Regarding the implementation for communities where Final Determinations have already been issued, see above.

Regarding your question about the costs to develop and apply the new methodologies, these costs estimates are under development. As we refine and finalize the new methods, we will be developing more detailed cost estimates and, moreover, assessing overall cost impacts to the Risk MAP program. Further, as part of this effort we are concurrently assessing the impacts of implementing these new methodologies to Risk MAP program objectives within projected funding levels.

**Q.7.** Can you provide an estimate of the percentage of properties in Special Flood Hazard Areas that maintain flood insurance policies?

**A.7.** Based on our research, FEMA estimates that approximately 24 percent of the properties in Special Flood Hazard Areas (SFHA) purchase flood insurance policies. The retention rate for SFHA properties in FY2010 was approximately 67 percent.

**Q.8.** It is my understanding that the Federal Government holds easements for properties in the Morganza Floodway and that the Morganza Spillway has been operated twice since it was built in 1954, flooding these properties twice in less than 50 years.

How are properties in the Floodway classified on FEMA's flood maps? To what extent are Army Corps inundation maps and scenarios integrated into FEMA's flood maps?

As a general rule, how are Army Corps data, including inundation maps and scenarios, used in developing FEMA flood maps?

**A.8.** FEMA's Flood Insurance Rate Maps (FIRMs) currently show the entire area behind the spillway within the Special Flood Hazard Area. The USACE inundation maps and mapping scenarios are not incorporated into the FEMA FIRMs, although the inundated area is reflected as within the Special Flood Hazard Area.

The USACE utilizes inundation maps for these flood control structures as an operational component to plan controlled water releases. If the water level reaches a predetermined height above the spillway, the inundation maps show how the flood control structure will function, operate, and reflect the areas that would be flooded as a result of a particular scenario. This information allows emergency management staff at a Federal, State, and local level to prepare for initial response and recovery activities prior to the event. FEMA's FIRMs reflect a flood hazard for a specific statistically probable flood event, which is the 1 percent annual chance flood event. While these two products seem similar, their uses are different. The USACE's inundation maps are intended to provide operational information for a particular structure and FEMA's FIRMs reflect flood risk based on statistical probability. Generally, FEMA maps do not consider the operational aspects of any spillway but FEMA does account for the unimpeded flow above the spillway for the 1 percent annual chance flood event.

**Q.9.** Can you comment on the data that private insurers of large commercial properties use in evaluating flood risk and how those practices can be utilized in the National Flood Insurance Program?

**A.9.** Over the last 5 years insurers and reinsurers of large commercial properties have begun to utilize more sophisticated techniques to evaluate the flood risk for individual buildings and for portfolios of buildings. Generally, those techniques start with FEMA's D-FIRMs, although the insurers typically require more detailed information than is provided on the FIRMs, particularly for areas outside of FEMA's defined floodplains. They use various additional sources of data to enable them to make probabilistic calculations of flood risk. Those other sources include the USGS Digital Elevation Model, satellite imagery, USGS river gauge data and various types of models for storm surges caused by hurricanes and other ocean storms. FEMA is interested in following those developments, and the mapping and actuarial components of FEMA have met with a number of insurance company developers of flood risk models to better understand their techniques.

---

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM W. CRAIG FUGATE**

**Q.1.** I would like to thank you for changing your "without-levees" mapping method in response to our letter, and would also like to thank you for the commitment you made at the June 9 hearing to remap areas that were already done with the "without-levees" method. Communities such as Warrenton, Oregon, that have already adopted the less scientifically sound maps must pay for costly flood insurance policies while they wait for these areas to be remapped. Could you provide information on the timeline for the remapping and also any anticipated costs that will fall on local communities during the remapping?

**A.1.** FEMA anticipates that the new methodologies will be completed during the Fall of 2011. While FEMA wants to move pending mapping activities forward as expeditiously as possible, we also believe it is imperative to follow a deliberate, collaborative approach to develop quality methods and guidance and allow for consideration of public comments before finalizing the new methodology. Therefore, FEMA has established a multidisciplinary team of experts made up of representatives from FEMA, the U.S. Army Corps of Engineers, academia, and the engineering industry to evaluate the available science and develop new levee analysis and mapping methodologies suitable for the National Flood Insurance Program. To provide independent, objective input, an Independent Scientific Body made up of recognized experts convened by the National Institute of Building Sciences is reviewing and providing comments on the new methodologies. Further, because of the importance of these new methods to communities with levees, in the coming months we will conduct focus groups of community officials and levee boards across the Nation. Finally, FEMA will make the methodologies available for public review and comment. Once these reviews have been completed and feedback addressed appropriately, FEMA will issue new guidance for analyzing and mapping levee systems under the NFIP. At that time, FEMA will review impacted studies and be in contact with affected communities regarding the next steps in the mapping process.

As opposed to the current practice of using a single "without levee" approach for analyzing and mapping nonaccredited levees, FEMA is developing a suite of methodologies. For each flood protection levee, FEMA will collaborate with the community and/or levee owner to select from this suite the best method for analyzing and mapping the levee that balances the need for accuracy, detail, and precision against the available mapping budget. Factors that will be important in selecting the appropriate method include levee system characteristics; flooding parameters; vulnerability of buildings, infrastructure, *etc.*, within the area protected by the levee; and quality and availability of data necessary to perform analyses. The suite of methodologies is specifically being designed to accommodate communities that are unable to provide any data or analyses to the mapping effort. However, because FEMA must operate within the fiscal constraints of its available budget for flood studies and mapping, communities or levee owners that are willing and able to contribute data and/or perform analyses will be more likely to receive more detailed analytical methodologies. Frequently this data will already be in the possession of the community or levee owner and, thus, the community or levee owner will be able to contribute to the analysis and mapping effort at little or no additional cost.

At this time it is difficult to determine when projects placed on hold pending new guidance will resume. However, our commitment to Congress places a great deal of importance on the Levee Analysis and Mapping Project, and appropriately, FEMA is aggressively working to meet this commitment. FEMA's priority when we implement the new methodologies will be to apply them to the nearly 250 ongoing studies that have been placed on hold pending development of the new levee analysis and mapping methodologies.

Where Final Determinations already have been issued (such as in Warrenton, Oregon), FEMA is developing its plan to retroactively apply the new methodologies. While the details of that plan are still being developed, retroactive application of the new methodologies will depend upon the available funding and almost certainly will require several years to accomplish. Thus, our plan will include a multiyear prioritization and sequencing component. Any community or levee owner wishing to revise the NFIP maps using the new procedures faster than the time frames afforded through the FEMA-funded study queue will have the option to submit the necessary data and analyses in support of a map revision request under the provisions of 44 CFR 65.

**Q.2.** Some of my constituents have complained about the policy of grandfathering in rates for properties that obtain flood insurance prior to the issuing of new maps. Their concern is that neighbors, who are active in local politics or who have been alerted by their insurance companies, know that they can save money by obtaining flood insurance before the new maps are adopted. However, others don't receive word and end up paying much higher premiums for the same flood risk. If FEMA is going to award these discounts, it is important to make sure everyone has a fair chance to benefit. What steps is FEMA taking to better communicate with property owners about these rate options?

**A.2.** FEMA's National Flood Insurance Program (NFIP) issues updated flood maps in communities to help residents understand their current flood risks and enable them to make informed decisions to address those risks. When local flood maps change, individuals newly mapped into a high-risk zone may be required to carry flood insurance because of the heightened risk they now face. The NFIP recognizes the potential financial burden that this may cause and offers significant financial savings, through the NFIP's grandfathering provision and recent Preferred Risk Policy extension, to help residents stay protected at a reasonable more affordable cost. To ensure that individuals across the country understand, and take advantage of these cost saving options, the NFIP engages in regular outreach to communicate about map changes and flood insurance options.

FEMA's Federal Insurance and Mitigation Administration actively tracks communities that are releasing new flood maps and provides a range of materials on map changes and their impact on flood insurance requirements and costs at community meetings. FEMA's information and on-the-ground assistance not only helps residents understand map changes and insurance implications, it also provides the practical guidance needed to help citizens take advantage of cost saving options that come into play when local risks change.

Recognizing the broad impact of map changes on communities nationwide, the NFIP has developed, and regularly distributes and promotes, a suite of fact sheets, tools, and materials that help explain ways to save on coverage through the grandfathering rule when it issues new flood maps at the local level. We distribute these materials at a host of conferences and stakeholder meetings nationwide and they reside on FEMA's FloodSmart Web site (*www.floodsmart.gov*), enabling widespread access to, and application of this important information.

The NFIP has also recently expanded eligibility for its lower-cost Preferred Risk Policies (PRP). To raise awareness of this new program, which launched in January 2011, the NFIP sponsored extensive insurance agent trainings to help them counsel customers on the new option and distributed a series of fact sheets, backgrounders, and frequently asked question (FAQ) documents to help residents take advantage of these new, significant savings.

The NFIP also continually encourages flood insurance protection in moderate- to low-risk flood areas and offers discounted rates to ensure that residents in these areas make the right choice and obtain dependable protection. PRPs start at just $129 per year and offer the same level of protection as a standard flood policy. To promote PRPs to eligible residents and encourage affordable coverage, the NFIP distributes monthly direct mailings detailing the availability of this reduced cost option and regularly promotes information and materials on PRP to agents, local leaders, and floodplain officials to help them educate residents about how they can effectively stay protected for a modest investment. The NFIP has run a national broadcast television spot to promote the PRP with consumers and placed PRP-related online banner advertisements on various Web sites throughout the country.

---

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR VITTER FROM W. CRAIG FUGATE**

**Q.1.** During the February 18, 2011, conversation with FEMA's Jonathan Wescott, the request was made by St. Tammany Parish to allow a "Partial Map Adoption." Subsequent conversations with FEMA Project Managers have assured communities that this is being considered and a feasibility study is under consideration. However to date, only one community in St. Tammany Parish (Mandeville, Louisiana) has been given verbal notice that FEMA will allow their Community Based Maps to be published (municipality only).

What is the status of the feasibility study to allow "Partial Map Adoption" for the rest of the Parish?

Will the same contractors, who created the preliminary DFIRMs that are currently under Appeal by St. Tammany Parish, be allowed to participate in this process?

Has a budget been proposed for this study?

Is there funding available for the feasibility study to allow Partial Map Adoptions?

**A.1.** FEMA evaluated the possibility of a partial map adoption for the unincorporated areas of St. Tammany Parish. However, due to the configuration of the map panels as it related to panels affected by levees, along with a need to ensure flood hazards match along map edges, complicated community compliance issues, and the lack of a good location to segment the maps, partial map adoption was not a feasible approach for the unincorporated areas of St. Tammany Parish. Furthermore, at a recent meeting with Mandeville and St. Tammany Parish officials, Parish officials agreed that a partial map for unincorporated areas would present significant permitting and enforcement issues. Region 6 has not been approached by any other incorporated communities within the Parish to look at moving forward with a community based map.

The current contract expires at the end of September. The intent is for the current contractors to resolve all appeals unrelated to the areas affected by levee guidance and coastal structure guidance and to complete the community based map process for the City of Mandeville to maintain continuity. At that point the study will be put on hold until the new levee guidance is finalized.

For the City of Mandeville's community based maps, the contractor anticipates submitting for Quality Review at the end of September with a final Letter of Final Determination sometime towards the middle of December. Additional contracting mechanisms are being explored to extend the current contractor long enough for the contractor to finish the Mandeville Community Based Map.

There is adequate funding available to complete partial map adoption for the City of Mandeville. There is uncertainty on the budget needs to complete the remainder of the study for St. Tammany Parish as it will be affected by FEMA's new approach to analyzing and mapping unaccredited levees.

No, additional funding will have to be secured for any further investigation into the feasibility of additional community based maps.

**Q.2.** In FEMA's response to the February 3, 2011, Senate letter, FEMA states they will respond to congressional and local criticism by terminating the "without levees" practice. They will work to formulate a new methodology that takes into account lesser protection levels (*i.e.,* "give credit for partial protection" to uncertified/decertified levees and coastal structures).

Has FEMA begun work on the proposed "New Approach" to address uncertified/decertified levees, Coastal Structures and Coastal Levees?

Will FEMA solicit input on the Coastal Levee Guidance procedures during their development? If not, why not? Communities are more familiar with the situation on the ground and have had years of experience dealing with their levees.

Will there be any changes to the FEMA guidelines on the treatment of nonlevee coastal structures? These structures are very important in Louisiana for reducing flooding and providing partial protection.

Will FEMA develop guidelines for the treatment of coastal restoration projects, such as mash creation and barrier island restoration, in the floodplain mapping? The principle of the Multiple Lines of Defense, the basis for Louisiana's coastal planning, assumes that restoration projects will be credited with some flood protection benefits.

Will the same contractors, who created the preliminary DFIRMs that FEMA has agreed to withdraw, be used to remodel DFIRMs in this "New Approach"?

Remodeling depends upon obtaining additional funding. Has FEMA proposed a budget for the remapping effort? Will the proposed budget be made publically available?

FEMA expects all mapping efforts to be delayed by months, not years; however, remapping is dependent upon funding AND completion of the NEW Coastal Levee Guidance. Is there any information on the timing of a Federal Register notice?

FEMA has stated that they will solicit for public comment on this new methodology for Coastal Levee Guidance. Will these comments be made available to the public?

Will FEMA allow adequate time for public review and comment once the "New Approach" is proposed?

What is the status of the Science Review Panel with respect to the treatment of coastal structures and levees in the mapping effort?

Have any communities entered into this phase of Appeal? Will their concerns be made available to the public and/or other communities who are in DFIRM Appeal with FEMA?

**A.2.** Work has begun on the proposed new approach to address uncertified levees, including coastal levees. However, the ongoing effort to update FEMA's methodologies for the treatment of uncertified levees in flood hazard mapping for the NFIP is specific to levees. New methodologies for the treatment of nonlevee coastal structures, which are not analyzed using the "without levees" practice and not covered by 44 CFR 65.10 certification standards, are not being developed at this time.

Yes, FEMA will welcome comments on coastal levees as part of this new approach.

See response to first bullet. It should be noted however that current guidelines allow for evaluating the partial protection that may be afforded by nonlevee coastal structures that are expected to fail during a base flood. This is accomplished by utilizing an appropriate failed structure configuration in the overland wave modeling.

FEMA does not currently have guidelines specifically addressing the treatment of the coastal restoration projects mentioned above in an NFIP flood study. However, that does not mean that the effects of these types of projects cannot be reflected on the FIRM. FEMA uses highly detailed topographic and bathymetric data and information about land use and vegetative cover in the development of its flood models and resultant hazard mapping. Completed coastal restoration projects typically alter the topography and/or bathymetry in the vicinity of the project. The effects of these alterations, including any changes to the vegetation present at the site, can be incorporated into the FIRM at any time after the project completion. In situations where these projects impact Base Flood conditions FEMA encourages communities to provide the information needed to update the maps to reflect the effects of these projects within 6 months of it becoming available in accordance with NFIP regulations (44 CFR 65.3).

Yes, where it makes sense to do so and in coordination with impacted communities.

FEMA is currently performing an analysis of costs associated with the new levee approach.

FEMA will publish a notice for a public review period in the Federal Register.

Comments will be analyzed and grouped into themes. The major themes of the comments may be posted to the FEMA Web page for the Levee Analysis and Mapping Project (LAMP).

At this time, no community has requested a Scientific Resolution Panel (SRP) to review data relevant to coastal structures or levees in the mapping effort. However, FEMA is utilizing the SRP to convene an Independent Scientific Body, comprised of technical and scientific experts, to review and comment on the proposed new approaches for depicting the flood risk associated with nonaccredited levee systems. The proposed approaches account for the treatment of coastal levees that cannot be accredited.

At this time, two communities have requested an SRP and were eligible in accordance with the guidance provided publicly in Procedure Memorandum No. 58, entitled "Implementing the Scientific Resolution Panel Process." Both are currently in the SRP process, and their concerns are publicly available at the following Web site: *http://www.floodsrp.org/panels/*.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR COCHRAN FROM W. CRAIG FUGATE**

**Q.1.** Administrator Fugate, as you know, we have been very clearly reminded over the past couple of months that a lot of valuable real estate in the Mississippi River Valley is protected from flood waters by the world's best levee system. Having intimately experienced Hurricane Katrina and the recent floods, we take seriously the need of the National Flood Insurance Program to accurately reflect risk to the public. However, Senators from all over the Nation are hearing from their constituents regarding FEMA's Map Modernization efforts.

Do you share my view that there are practical changes we can make to FEMA policy that might mitigate some of the concerns of communities without adversely affecting risk identification or the solvency of the NFIP?

**A.1.** FEMA is committed to reforming the National Flood Insurance Program. Specifically:

- In January 2011, FEMA's NFIP Reform Working Group completed the refinement of policy alternatives and began the policy evaluation phase.
- The evaluation was conducted through the Spring in cooperation with Keybridge Research, a independent policy analysis firm.
- The evaluation involved both a qualitative and a quantitative assessment of each of the policy alternatives and identified each policy's strength and weaknesses.
- The Working Group has recently received the initial findings of this assessment and have found that no single idea prevails but that there are strengths in each of these areas that could be combined to form a holistic reform package.
- The Working Group has been asked to continue working through the summer.

**Q.2.** What consideration does FEMA give to ongoing flood control projects when remapping an area? Is it prudent to remap an area when there is a reasonable amount of certainty that the flood risk of that area may change dramatically very soon due to the completion of a flood control repair project? Wouldn't you then have to use more Federal resources to map that area again in order to keep up with flood risk?

**A.2.** FEMA coordinates with communities as new flood control projects are built or older infrastructure is repaired or upgraded. In our experience, many construction projects encounter delays, and FEMA is concerned about a possible flooding event in the interim.

For projects in progress, FEMA has an available remedy. In accordance with 44 CFR 61.12, FEMA may issue adequate progress determinations for flood protection systems (*i.e.,* levee systems) construction or restoration projects involving Federal funds that may significantly limit the area of a community that will be included in the identified Special Flood Hazard Area (SFHA). The SFHA is the area that will be inundated by the 1 percent annual chance flood. Such projects reduce, but do not eliminate, the risk of flood to people who live and work behind levee systems and to the structures located in these levee-impacted areas. The Chief Executive Officer of the community or other responsible community official may request that FEMA make an adequate progress determination for a construction project and revise the effective FIRM to designate the SFHA in the impacted area as Zone A99.

In all cases, FEMA works to expeditiously update the flood hazard depiction upon completion of the project.

**Q.3.** Do you believe communities who contribute constructive scientific data to the remapping process should be compensated for their troubles? Why should communities in some cases have to expend local funds to prove that the Federal Government got it wrong?

**A.3.** The NFIP is a partnership with local communities, and identifying flood hazards is not the sole responsibility of FEMA. In a resource constrained environment, FEMA must make sound investment decisions. FEMA is committed to the accuracy of all our Risk MAP products. The additional data rarely is about demonstrating that the draft FEMA product is wrong; usually the scientific data brings higher resolution to the product. We view such enhancements as a mutually beneficial contribution from the local partner.

FEMA strives to provide data and information at a resolution sufficient to meet NFIP objectives of reducing future flood risk and ensuring a sound means upon which to fairly price flood insurance.

**Q.4.** What is your flood insurance adoption rate among those who are required to participate in the NFIP?

**A.4.** Ninety-seven percent of the 2,103 communities adopted the Flood Insurance Rate Map (FIRM). Only 73 communities did not adopt the FIRM and were suspended from the NFIP.

**Q.5.** What are your assessments of the performance of the Mississippi River and Tributaries System during this ongoing historic flooding? How do the successes of this system affect your level of confidence in the risk reduction capabilities of our Nation's flood control infrastructure?

**A.5.** FEMA does not evaluate the specific performance of flood control systems. The U.S. Army Corps of Engineers along with the Mississippi River Commission provide oversight and management of the Mississippi River and Tributaries System.

**Q.6.** Should it be the policy of the United States that people not live behind levees?

**A.6.** Water is an integral part of the American society; water sustains life and moves commerce. While there is always a risk of flooding for businesses and homes behind levees and those affected must know their risk, FEMA leaves it to local communities to make wise land-use decisions about flood control.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

## PREPARED STATEMENT OF SENATOR RICHARD J. DURBIN OF ILLINOIS

Chairman Johnson and Ranking Member Shelby, thank you for this hearing on the reauthorization of the National Flood Insurance Program. I appreciate the opportunity to share my views on this program with the Committee.

Discussion of reauthorization of the NFIP could not be more timely for Illinois. Today, hundreds of people in Southern Illinois are cleaning up after flooding from the Ohio and Mississippi Rivers inundated the region this April and May. President Obama has declared 21 counties in the southern part of my State Federal disaster areas. I am grateful that both Federal individual and public assistance will be made available there, and I will continue to do all I can to ensure that the affected communities have the help they need.

The National Flood Insurance Program is the primary Federal resource available to help people and communities recover from flood damage. The program expires on September 30th of this year. There are many challenges to its reauthorization, not the least of which is its estimated $18 billion debt. The program should be reworked to be more actuarially and fiscally sound.

We need to update our perception of weather patterns. In Illinois, the frequency of what once were considered 100- and 500-year flood events suggests we need to adapt to a more realistic expectation of flooding frequency and severity. This means accounting for evolving flood zones, through a fair and accurate flood mapping process.

As flood maps are updated, the people who live in newly mapped flood zones have to adapt to the cost of mandatory insurance. The program should take into consideration efforts that are made by communities to shore up protections against flood events. Today, when a community learns it will be mapped into a flood zone, no consideration is given to account for that community's efforts to bolster its levees. Instead, residents of the newly mapped zones must purchase insurance, even while paying to bring their levees back up to the standard of 100-year flood protection.

This is exactly what happened in Metro East, Illinois, where most people have never experienced a flood. The community received a double whammy when it learned the levee no longer meets the 100-year flood protection standard and that it was being mapped as a flood zone. The community began collecting revenues to help repair their levee. Because they are proactive in addressing the infrastructure, residents feel that the requirement to purchase flood insurance does not make sense. For communities like Metro East that are investing in their levee and that have not had a flood, we should be reasonable about the mandatory insurance requirement. The Flood Insurance Program should fairly and accurately reflect communities' risk, while taking into account efforts underway to guard against a major flood.

I commend the Committee for addressing the challenges facing the flood insurance program's reauthorization. I look forward to seeing the bipartisan measure being developed by the Committee and am happy to help in any way I can to see it passed.

Thank you.

**STATEMENT SUBMITTED BY THE NATIONAL ASSOCIATION OF REALTORS®**

NATIONAL ASSOCIATION of REALTORS®
REALTOR®

500 New Jersey Avenue, N.W.
Washington, DC 20001-2020
202.383.1194 Fax 202.383.7580
www.realtors.org/governmentaffairs

Ron Phipps
ABR, CRS, GRI, GREEN, e-PRO, SFR
2011 President

Dale A. Stinton
CAE, CPA, CMA, RCE
Chief Executive Officer

GOVERNMENT AFFAIRS
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Jamie Gregory, Deputy Chief Lobbyist

## STATEMENT OF THE

## NATIONAL ASSOCIATION OF REALTORS®

## SUBMITTED FOR THE RECORD TO THE

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

## HEARING REGARDING

## REAUTHORIZATION OF THE NATIONAL FLOOD INSURANCE PROGRAM

## JUNE 9, 2011

## Introduction

On behalf of 1.1 million members engaged in all aspects of residential and commercial real estate, the National Association of REALTORS® (NAR) appreciates the opportunity to submit this written statement regarding reauthorization of the National Flood Insurance Program (NFIP). NAR urges Congress to reauthorize the NFIP for a full five-year term and end the many stopgap extensions and shutdowns that have only exacerbated uncertainty in recovering real estate markets.

The NFIP ensures access to affordable flood insurance for 5.6 million American home- and business owners across the United States. This protection is vitally important as annual flooding claims dozens of lives and billions of dollars in property loss, making it one of the most prevalent and expensive natural disasters in U.S. history. By law, flood insurance is required in order to obtain a federally related mortgage in more than 21,000 communities nationwide. By adopting NFIP regulations and building codes, these communities have averted $16 billion in property loss since 2000, according to the Department of Homeland Security. This program saves taxpayers both property and money.

The program is again set to expire on September 30, 2011. This will be the **tenth time** in less than three years that Congress has had to extend program authority. **Twice**, that authority was allowed to expire in 2010 for multiple weeks each time. The lapse last June alone, during a down real estate market, resulted in the delay or cancellation of 47,000 home sales according to NAR survey data. While we thank the House for including a straight one-year extension in its Homeland Security appropriations bill for 2012 (H.R. 2017), we believe that five years is the minimum timeframe necessary to provide some certainty for real estate markets, which continue to struggle amid the longest recession since the Great Depression. In any event, we urge the Senate not to let the NFIP lapse again, as that would only further undermine the already fragile confidence in these key markets upon which the U.S. economic recovery depends.

Before turning to specific reforms, we would like to discuss the legislative history and address several common myths about the NFIP. In short, the NFIP was created and continues to address an on-going failure of the private market to provide access to affordable flood insurance. Without this program, the only way for many owners to rebuild after a flood would be for the federal government to appropriate post-disaster rebuilding assistance – using taxpayer dollars.

## Legislative History

The NFIP was created in 1968 after Hurricane Betsy because there was no private market alternative for flood insurance. Historically, most communities were built along rivers and coastlines. Because flood victims could not turn to the private market to insure and pre-pay for the flood damage, many communities were forced to look to the federal government for rebuilding assistance. Given the level of devastation and homelessness among families and communities, Congress had little-to-no choice but to respond to each major flood with yet another supplemental disaster relief package of subsidized loans, grants and public assistance – all at taxpayer expense.

In the aftermath of Hurricane Betsy, the federal government could no longer ignore the rising cost to taxpayers of such a backward-looking public policy toward floods. One of the champions of a federal flood insurance program, Rep. Hale Boggs said it best:

*"…As you know, I represent an area which 2 years ago was horribly battered by Hurricane Betsy. But hurricanes and floods are not district or regional problems. They are national problems. No one knows where they will strike. And they require national solutions now before thousands more are hit without adequate protection. Mr. Chairman, we should attack this problem through an insurance program instead of relying totally on direct Federal subsidies to the victims of floods basically for two reasons: First, our people want the opportunity to protect themselves. They do not want to rely on relief agencies, Government largesse, or charity. They want to protect themselves and it is up to us to help them do it. Passage of this legislation will go a long way in helping people to protect themselves against flood disasters. Second, as I said a moment ago, we have relied on ad hoc, piecemeal relief measures for many years and it is now abundantly clear that, although these temporary programs have been helpful, they are insufficient and quite costly. We have been legislating after the fact and it is time to plan for the future rather than react to the past…."*[1]

The result was establishment of a HUD Commission, authorized by Congress and convened by President Johnson, which in 1966 recommended creation of a federal flood insurance program as an alternative to the government rebuilding aid. According to the Commission, every insured property would mean one fewer property would have to be rebuilt with taxpayer dollars.

Although the NFIP has been reauthorized multiple times over the years, the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (P.L. 108-264) was the last multi-year reauthorization bill to become law. Subsequently, the 110th Congress was on the verge of approving a subsequent reauthorization (H.R. 3121, the Flood Insurance Reform and Modernization Act), but did not convene a conference committee as attention turned to the problems facing the U.S. financial system. The Congress did return to the subject last session, when the House approved and the Senate began its review of the Flood Insurance Reform Priorities bill, H.R. 5114, with a hearing at which NAR testified about the program's importance. Ultimately though, the 111th Congress was not able to complete its work on the legislation and the NFIP's authority had to be extended for the ninth time, bringing the total number of lapses since 2008 to five; two of these lapses were for multiple weeks just last year. The program is next set to expire on September 30th of this year.

**Common Myths**

Neither data nor fact supports assertions of 1) the ability of a private market for flood insurance to fill the void left by privatizing the NFIP; 2) the existence of a cross subsidy from non-coastal to coastal states under the program; or 3) a cost to taxpayers from NFIP borrowing or repeated pay-outs for certain properties. It is simply the nature of a private market that it will not guarantee either the availability or the affordability of flood insurance. However, if the program is ended, the only way to rebuild after a flood would be for Congress to respond as it did prior to 1968, which is to approve more taxpayer-funded disaster relief.

*Myth #1: The Private Market Will Meet the Flood Insurance Demand.*

Legislation has been introduced by Rep. Miller of Michigan in the House (H.R. 435) to terminate the NFIP by 2013. NAR strongly opposes this bill or any effort to privatize the NFIP. The premise underlying such an effort is that there would be a sufficient private market to meet the flood

---

1 Congressional Report, "National Flood Insurance Act of 1967 (H.R. 11197)", regarding hearings before the Subcommittee on Housing of the Committee on Banking and Currency, U.S. House of Representatives, for the dates August 15 and 18; September 19, 20, and 21, 1967, page 3.

insurance demand more efficiently than the federal government. However, the NFIP was created in the first place because the private market had failed to insure flood risk. As a result, federal intervention was and continues to be justified today.

The market failure for flood insurance is one of information and adverse selection. Flood risk is inherently unpredictable, so property owners understandably under- or over-estimate their risk according to a subjective set of probabilities. The owners most likely to purchase flood insurance are also most likely to experience flood loss. Knowing this, private insurers would naturally have to be highly selective of whom and where they insure. In a private market, companies would be able to reject applicants when they do not believe that the potential losses would be offset by the estimated premiums. They would also have to set insurance rates at a level that reflects a pool of insureds that is skewed toward the higher risk properties. That rate would likely be set high enough that even those demanding insurance can no longer afford it, prompting them to opt out and the rate to be increased further to reflect those remaining in the pool. This in turn would cause another round of opts-out and rate increases, and so on.

The existence of this market failure is supported by the market research of RAND[2] and the General Accountability Office (GAO).[3] These studies find limited-to-no private market potential, as there are no governmental or other barriers to prevent private insurers from entering the flood insurance market today. GAO found that merely four large companies write what private flood insurance is offered in the United States. However, these companies write only for owners with "high net worth" and high-value property of "at least $1 million." RAND's analysis reinforced GAO's findings when it found fewer than 200,000 private policies in a market where the NFIP currently writes 5.6 million. Going from 200,000 to 5.6 million private policies would require a market to ramp up by 3,000% to meet the demand in only two short years were H.R. 435 enacted. RAND also surveyed current rates for these private policies and found that the rates ranged from 1.3 to 3.4 times that of "full risk" NFIP premiums depending on flood zone.

Because the private market would bear the full risk if the NFIP is ended, primary insurers would have to cede some of that risk to secondary markets and purchase reinsurance. They would also have to account for additional costs that a federal program would not incur, including taxes, the cost of capital (i.e., the rate of return to attract investors), and the profit paid to shareholders.

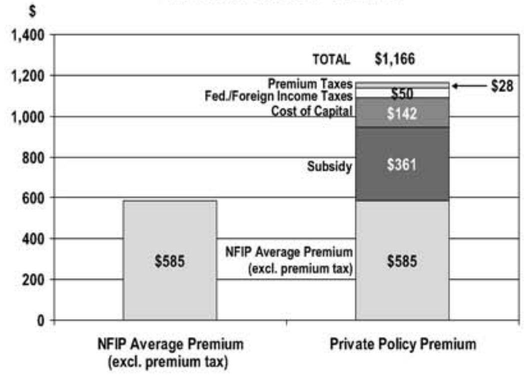
Building on RAND's private-policy rate survey, in a white paper, the Property Casualty Insurance Association of America (PCI) calculated how much the average NFIP premium would have to rise in order to cover these additional expenses.[4] According to PCI, the cost of capital and profit would add from $66 to $410 dollars to the average, depending on flood zone. The additional taxes would add from $23 to $143. Not included in the NFIP premium rate is the amount of the underwriting expense which the NFIP currently passes through to claims adjusters. That amount would also have to be added back at the end and is estimated to range from $13 to $82. In total, the average premium would double from $600 to approximately $1,200 according to PCI's estimates.

2 RAND Corporation, "The Lender Placed Flood Insurance Market for Residential Properties," 2007.

3 The GAO, "Information on Proposed Changes to the National Flood Insurance Program," Letter to Rep. Barney Frank, Report GAO-09-420R, February 27, 2009.

4 Property Casualty Insurers Association, "White Paper: True Market-Risk Rates for Flood Insurance," April, 2011.

**Figure 1**
**Average Private Flood Premium is Twice as Much as NFIP Premium**




**Source: PCI, based on NFIP Actuarial Rate Review and other sources**

The market cannot guarantee property owners' access to affordable flood insurance. That is simply the nature of a private market. Even if private insurers were able to obtain state-by-state approval to charge rates that are sufficient in the insurer's judgment to manage the additional expense and risk, few property owners (except perhaps the wealthiest) could afford flood insurance at double the average rate. Already less than 50% of those in the 100-year floodplain purchase flood insurance at the NFIP rate. The percentage is much lower for those in areas where flood insurance is voluntary. This helps explains why many primary insurers (which would stand to profit most from privatizing NFIP) have taken a public stand in **opposition** to privatization (e.g., see NAMIC's letter to FEMA dated December 29, 2010). The profit potential is simply not there. Just the potential for negative publicity of likely rate hikes alone would not justify the opportunity for most of these companies.

At the same time, the federal government would still have to assist in community rebuilding efforts after a flood. Imagine if Congress had not responded to TV images of New Orleans families living in makeshift tents in the Superdome after Hurricane Katrina. The amount of federal assistance will not decline if there is no longer an NFIP; the only difference would be in the form of assistance the federal government provides. Rather than authorizing a federal program to collect premiums from property owners to cover their claims in a typical year, Congress would likely have to increase the amount of taxpayer-subsidized SBA loans, grants and public assistance to these communities. By increasing the number of insured properties, the NFIP reduces the number that would have to be rebuilt at taxpayer expense. In fact, the NFIP reduces taxpayer burden by providing an alternative to expensive post-disaster relief.

*Myth #2: The NFIP Benefits Coastal States at Non-Coastal States' Expense.*

In 2008, a GAO study of NFIP rate setting was supplemented by a state-by-state analysis that added up claim payments and premiums from 1978 to 2007 and then subtracted the total premiums from the total claims.[5] GAO was building on an earlier report by the Congressional Research Service (CRS).[6] Because these analyses showed that some coastal states were receiving more in claims than they paid in premiums over time, some concluded that losses in these states must be cross subsidized by premiums paid in non-coastal states. The argument made was one of lack of fairness that non-coastal states are being forced to pay into a program from which they are getting relatively little in return. One observer likened the NFIP to an "ATM machine" that non-coastal states pay into in order for other states in the path of hurricanes to finance community rebuilding efforts along the coast, which from their point of view, is irresponsible.

However, such judgments are based on one interpretation of partial analyses that were not designed for that purpose. Underlying these judgments are premises that a) some states are facing a higher flood risk and not paying proportionate to risk; b) lower-risk states are making up the difference by paying more than their fair share; and c) historic claims data can be used to identify which states are low risk and cross subsidizing the others. Yet, CRS and GAO were not analyzing the risk to states. Indeed, GAO explicitly acknowledged the limitations of relying on this type of analysis to draw such conclusions:

> "*We recognize that flooding is a highly variable event, with losses varying widely from year to year, and that even an analysis of nearly three decades of historical data could lead to unreliable conclusions about the actual flood risk faced by a given state.*" [7]

Rather, CRS was concentrating on the subset of properties with repetitive insured losses under the NFIP. GAO was looking for a pattern in insurance pricing among states with "high-loss" years (i.e., years when a state's annual claims exceeded its premiums). The idea was that if some states frequently had high-loss years, and policyholders in these states were paying the same rates as those in other states, it could raise questions about the NFIP's rate structure.

The fact that certain states have not recently flooded at a magnitude that the total claimed exceeded the amount paid does not prove it never will. As GAO's analysis shows, historically, Louisiana had paid $428 million more in premiums than claims when Hurricane Katrina struck in 2005. Floods are caused by rising rivers, storms, snow melt, *and* man-made problems with construction, development and structures, as well as hurricanes. They have happened in every state, year around *and* just about anywhere and anytime that rain has fell. Their occurrence is inherently difficult, if not impossible to predict. Even a property with a 2% annual risk of flooding has a 50-50 chance of having no flood during a 35-year period. The lack of a flood over this period does not prove that the house will never flood; a 2% annual risk is a very high risk structure. Rather than focusing on the claims history, the more relevant question is which states are more exposed to flooding *today*, and that would depend on a) a state's concentration of the high-risk properties most susceptible to flood damage; and b) how many of these properties have flood insurance to pay for the future damage, rather than taxpayers via federal disaster assistance.

---

5 GAO, "Flood Insurance: FEMA's Rate-Setting Process Warrants Attention," Report GAO-09-12 (October 2008), see Table 4.

6 CRS, "Federal Flood Insurance: The Repetitive Loss Problem," Report RL32972, see Appendix C.

7 GAO, Page 25.

Furthermore, while the GAO did adjust for inflation, neither analysis accounted for whether high-loss years corresponded with high-premium years. For example, in the early 1980s, Michigan had several high-loss years in a row according to the FEMA data; in 1980, 1981, 1982, 1985, and again in 1986, the state's claims exceeded its premiums. At this time, Michigan had approximately half the number of policies it does today (13,000 on average from 1980-86 vs. nearly 26,000 in 2009). If the analysis were limited to that time frame, the state would have ranked among the larger net losers to the NFIP. Fortunately, were Michigan to experience a similar level of claims today, the flood risk would be spread out over a larger number of insured properties distributed over a wider geographical area. The 30-year difference, to which the critics point, will not provide a complete picture of state risk.

The GAO did improve on the CRS analysis by also ranking states by the number of high-loss years. If one focuses on states with the highest numbers, one would find that seven of the top 12 were not coastal states at all: Missouri, West Virginia, Illinois, Ohio, Oklahoma, South Dakota and Kansas. At the other end of the spectrum, five of the bottom 12 states (those with the fewest high-loss years) had a coastline: Georgia, Oregon, South Carolina, Florida, and Alaska. For example, not only did Florida's 2 million policyholders pay $10 billion more in premiums than the amount of claims paid out over 30 years but they also saw only one year when their annual claims exceed premiums. Compare that to, say, Illinois with 48,000 policies but nine (9) high-loss years – the seventh highest number in the ranking.

As it noted, the GAO did not include the amount paid to claims adjusters in calculating total premiums minus total claims:

> *"It is important to note that claims equaling premiums in a given year would not indicate a break-even year, because in addition to covering expected claims in a year, a portion of premiums is also intended to cover expenses necessary to operate NFIP."*[8]

By not including the NFIP's administrative expenses in the calculus, any surplus (i.e. when premiums exceed claims) would appear larger than it really was. If we reproduce the GAO's analysis but add two years of FEMA data (2008 and 2009) as well as the administrative expenses to the claim totals before subtracting premiums, Illinois would have 11 high-loss years; Florida would have three. The full results are appended to this testimony.

8 Ibid., p. 24.

| Table. Top/Bottom Net-Loss States | |
|---|---|
| State | Number of Years that Claims Exceeded Premiums 1978-2007 |
| TOP 12 | |
| Missouri | 11 |
| West Virginia | 11 |
| Mississippi | 10 |
| Louisiana | 10 |
| Texas | 9 |
| Alabama | 9 |
| Illinois | 9 |
| Ohio | 9 |
| New Hampshire | 8 |
| Oklahoma | 7 |
| South Dakota | 7 |
| Kansas | 7 |
| BOTTOM 12 | |
| Georgia | 3 |
| Utah | 2 |
| Wyoming | 2 |
| Nevada | 2 |
| Vermont | 1 |
| Idaho | 1 |
| Oregon | 1 |
| South Carolina | 1 |
| Florida | 1 |
| Alaska | 0 |
| New Mexico | 0 |
| Colorado | 0 |
| Source: GAO | |

While the number of high-loss years does provide a meaningful data point, the GAO also uses other approaches to analyze whether states are paying more or less than their fair share into the NFIP. As the GAO noted, "Florida, Texas, and Louisiana are among the states with the most NFIP policies, and therefore have a more significant impact on the amount of premiums collected than other states."[9] These states contribute the most to NFIP's overall capacity to offset flood losses nationally in any given year. RAND estimated that although the NFIP's participation rates in flood zones exceeded 60% in the South and West, they are closer to 20% in the Midwest and Northeast.[10] In a separate report,[11] the GAO provided a series of anecdotes, including the following three:

- "The five combined states of Iowa, Michigan, Minnesota, Missouri, and Wisconsin, when compared to Collier County, Florida, had more county flood disaster declarations (2,092 versus 12), significantly more flood claims payments ($704,706,000 versus $12,483,000), and

9 Ibid., page 25.

10 RAND, "The National Flood Insurance Program's Market Penetration Rate: Estimates and Policy Implications." Prepared as part of the 2001-2006 Evaluation of the National Flood Insurance Program, 2006, see Table 4.1.

11 GAO, "Flood Insurance: Options for Addressing the Financial Impact of Subsidized Premium Rates on the National Flood Insurance Program," Report GAO-09-20 (November, 2008).

a much larger population (28,906,000 versus 297,000), but a similar number of NFIP policies (80,572 versus 85,246)….

- "….Wisconsin, when compared to Rhode Island, had many more county flood disaster declarations (276 versus 11), but had similar flood claims payments ($32,693,000 versus $34,219,000). Even though Wisconsin has a much larger population (5,479,000 versus 1,012,000), it has a similar number of NFIP policies (12,945 versus 14,432)….

- "….The four combined states of Kansas, Nebraska, South Dakota, and North Dakota, when compared to Oregon, had more county flood disaster declarations (1,346 versus 124) and three times more in flood claims payments ($244,828,499 vs. $76,727,971), but a similar number of policies (30,683 versus 29,780) for a much larger population (6,009,000 versus 3,613,000)."

From the same report, GAO found 66 counties where there had been at least one major flood at a magnitude to prompt a presidential disaster declaration, yet none of these communities were participating in the NFIP, such as:

- "Winneshiek County, Iowa (population 21,188) has had seven flood declarations.

- "Adair County, Kentucky (population 17,575) has had six flood declarations.

- "Dallas County, Missouri (population 16,328) has had eight flood declarations."

These anecdotes raise legitimate questions about which states are shouldering their fair share of a flood burden borne by taxpayers and warrant a more systematic analysis.

Geographically, flood disasters are distributed fairly evenly across the United States. Using the number of presidential flood disaster declarations from 1990 to 2005 as a proxy, GAO color-coded a U.S. map (appended to this testimony) illustrating this.[12] Areas in orange, where there have been 6-10 declarations, pervaded every region of the country except the Mountain States. However, a large percentage of these mountainous regions have been designated public lands, so flooding may have occurred there too, but just not yet in a populated area or at a magnitude that prompted a major declaration. That could change. For example, Montana's governor declared a statewide flood emergency just a few weeks ago, where flood watches were issued for 13 Montana and Wyoming counties.[13] If, alternatively, one were to consider only populated areas, 97% of U.S. population lived in a county where at least one declaration was issued between 1990 and 2005. Nearly half experienced six or more major flood disasters.

It is true that many of these declarations occurred in coastal states but most high-risk areas are off-limits to the NFIP under the Coastal Barrier Resources Act of 1982. In the few coastal exceptions

12 GAO, "Natural Hazard Mitigation: Various Mitigation Efforts Exist, but Federal Efforts Do Not Provide a Comprehensive Strategic Framework," Report GAO-07-403 (August 2007), Figure 1.

13 USA Today, "Flooding cuts off Montana town" (May 24, 2011).

areas (designated "V zones"), the number of policies represented less than 2% of all NFIP policies in force from 1997 to 2006.[14]

| Table. Number of Policies in Force by Flood Zone, 1997-2006 | | | | | |
|---|---|---|---|---|---|
| | HIGH RISK | | MODERATE-TO- | | |
| | Coastal | NonCoastal | LOW-RISK | | V zone policies |
| Year | (zone V) | (zone A) | (zones B, C, X) | TOTAL | As % of Total |
| 1997 | 79,393 | 2,703,350 | 1,151,375 | 3,962,077 | 2.0% |
| 1998 | 84,332 | 2,801,370 | 1,199,032 | 4,114,319 | 2.0% |
| 1999 | 84,391 | 2,872,625 | 1,220,851 | 4,206,914 | 2.0% |
| 2000 | 82,481 | 2,904,796 | 1,239,448 | 4,255,425 | 1.9% |
| 2001 | 82,737 | 2,931,474 | 1,309,200 | 4,360,678 | 1.9% |
| 2002 | 84,876 | 2,970,972 | 1,313,551 | 4,406,664 | 1.9% |
| 2003 | 83,668 | 3,025,121 | 1,299,483 | 4,447,774 | 1.9% |
| 2004 | 83,946 | 3,126,322 | 1,320,107 | 4,558,696 | 1.8% |
| 2005 | 87,148 | 3,210,442 | 1,496,359 | 4,827,179 | 1.8% |
| 2006 | 105,183 | 3,350,209 | 1,889,242 | 5,404,952 | 1.9% |

In other words, 98% of NFIP policies were issued inland in such areas as the Red River Valley (between North Dakota and Minnesota) where 2010 saw that river's fifth major flood in a decade and 2009 broke the cresting record set more than 100 years before. Fargo, ND, in particular, has had nine "10-year floods" – i.e., floods that are expected to occur only once every 10 years—during the last 20 years, including one last March. There was a 100-year flood in 2009.15

Historically some of the worst flooding has occurred along rivers, not coasts. For example, the Midwest Flood of 2008 caused 24 deaths and cost $15 billion in property. The Midwest Flood of 1993 cost more than twice that in both loss of life and property (48 deaths, $30 billion) and continues today to be one of the most expensive disasters in U.S. history.[16]

In summary, while some may assert there is a cross subsidy from non-coastal to coastal states based on an interpretation of what the authors consider to be a partial and inconclusive analysis of the NFIP, the weight of data does not support the conclusion. Analyses of the number of high-loss years by state, loss history of states with similar NFIP policy numbers, NFIP participation rates by region, the U.S. distribution of flood loss geographically and by population, and the fraction of NFIP policies in coastal versus non-coastal high-risk areas – all point in the opposite direction.

*Myth #3: NFIP Debt and Repeated Pay-outs Cost Taxpayers Money.*

---

14 GAO, "NFIP: Financial Challenges Underscore Need for Improved Oversight of Mitigation Programs and Key Contracts," Report GAO-08-437 (June 2008), see Table 18.

15 Center for American Progress, "The Year of Living Dangerously: 2010 Extreme Weather Costs Lives, Health, Economy," (April 2011) pp. 8-9.

16 Lott, N., Ross, T., Houston, T., and A. Smith, 2010: "Billion dollar U.S. weather disasters, 1980-2010, Factsheet". [NOAA National Climatic Data Center, Asheville, NC, 3 pp.]

Recent reports have called attention to the NFIP's debt and repeated pay-outs for some properties.[17] The implication is this program is costing taxpayers' money. While citing a $17-billion-dollar debt and a property that has received more in claims than the value of the property may provide for eye-catching headlines and certainly sounds sensational, the truth does not lend itself to a sound bite.

The Congressional Budget Office (CBO) recently evaluated legislation to reauthorize the NFIP for five years and found zero budgetary impacts. Of the "Flood Insurance Reform Priorities Act of 2010" (H.R. 5114), the CBO concluded:

> *"Under both current law and under this legislation, CBO estimates that the NFIP could continue to make timely payments on valid flood insurance claims until the program's remaining authority to borrow from the Treasury is exhausted. Because provisions affecting premium income would have a minimal effect prior to the time the program exhausts the remaining borrowing authority (which, CBO estimates, would occur in 2013), we estimate that those changes would have no net effect on direct spending over the next 10 years….CBO estimates that the changes made to the NFIP by H.R. 5114 would yield additional premium income of $2.8 billion for insurance policies that FEMA can offer under current law. However, CBO estimates that those receipts would be spent to pay insurance claims expected under current law, resulting in no net change to direct spending over the 2011-2020 period."*

Reauthorizing the NFIP would not increase direct spending or add to the Federal Budget Deficit.

Historically, the NFIP has collected enough in premiums to pay the claims and expenses in most years. In the few instances when it did borrow from the U.S. Treasury, the program quickly repaid the loan in full with interest.[18] Such borrowing does not translate into higher taxes. For use of these funds that would otherwise be freed up for other uses, the Treasury charges an interest rate. Once the NFIP pays off the loan, taxpayers would lose the forgone interest.

However, 2005 was an outlier storm year, shattering numerous records (including most Category 5 hurricanes in a single season) and raising the prospects that the NFIP would not be able payoff the most recent loan in the near future. For 2005 and subsequently Ike and the 2008 Midwest Floods, the outstanding balance now stands at $17.5 billion. According to FEMA, this is an amount greater than the sum of all previous losses since the NFIP's inception in 1968.

CBO did estimate that the remaining borrowing authority for the NFIP would be exhausted in 2013, which is not captured in the standard budget presentation on a year-by-year cash basis.[19] However, this would not add to the Federal Budget Deficit either. As CBO put it,

> *"At that point [when borrowing authority exhausts], net spending for the program will be zero—payments would be limited to amounts deposited into the NFIP through premium and fee income, and additional borrowing would not be available. Thus, expenses exceeding NFIP deposits in a given year would be paid at a later date upon collection of future receipts."*

---

17 For example please see USA Today, "Huge Losses Put Federal Flood Insurance Plan in Red" (August 26, 2010).

18 Congressional Research Service, "NFIP: Treasury Borrowing in the Aftermath of Hurricane Katrina," Order Code RS22394 (June 6, 2006), page 3

19 CBO, "Budgetary Treatment of Subsidies in the NFIP," Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (January 25, 2006).

As for the "Repetitive Loss Properties" – the properties referenced in news reports that have received more in payouts than the property's value, we note that Congress previously addressed them once before. Under the Severe Repetitive Loss program established by the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (42 USC 4102A), owners of these properties were supposed to be presented with an offer to mitigate (or strengthen) their property against future flood risk. If the owner refused, upon future claims, the owner would see rate increases until the premium reached the full risk (actuarial) level. Yet, the mitigation program was not fully funded. While the statute is clear on the consequences of refusing a mitigation offer, it is more ambiguous about what happens when the owner simply chooses not to respond. Congress can and should take immediate, further action to address these properties that represent only 1% of NFIP properties but 30% of claims.

NAR strongly supports reforms to ensure that repetitive loss properties pay the full-risk rate and urges Congress to make the technical corrections and appropriations necessary for an effective mitigation program.

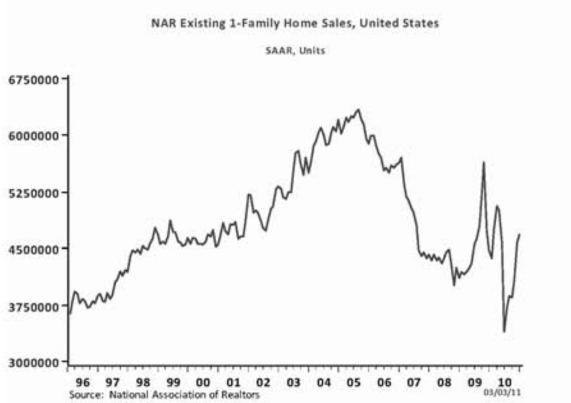
**Proposed Legislative Reforms**

In the 110th Congress, the Senate Banking Committee reported S. 2284, the Flood Insurance Reform and Modernization Act. While we continue to have concerns with some of the provisions, NAR strongly supports the bill's overall approach of reauthorizing NFIP for a full five-year term before the current deadline of September 30, 2011. We also support the goal of strengthening the NFIP's long-run fiscal solvency and welcome the opportunity to work with the Committee to achieve this goal. We note that a 5-year reform bill, H.R. 1309: the Flood Insurance Reform Act, was also recently approved by the unanimous, bipartisan vote of the House Financial Services, and is awaiting consideration by the House in the near future. Following are NAR comments on provisions which could be included in a potential Senate version of this legislation.

*Extension of NFIP Authority*

The Senate bill (S. 2284) would have reauthorized the NFIP for a full five-year term, and NAR strongly supports including such a provision in the next NFIP reform bill. We believe that five years is the minimum necessary to provide some certainty for the real estate markets to recover.

The housing market continues to recover from the longest recession since World War II. Home prices remain weak as distressed properties make up a significant portion of home sales. Many home buyers, who bought during the peak of the market, continue to be underwater and face foreclosures. The weak job market is also putting negative pressure on the housing market. Below is NAR's chart of existing home sales. While affordability remains strong and home sales are showing some signs of stabilization, the housing market is in a precarious position and cannot afford any further negative shocks.




The commercial real estate market is similarly struggling amid the greatest liquidity crisis since the Great Depression. Due to the economic downturn, commercial property values have fallen 43 percent across the board from their peak in 2007. Often it is the owner of America's small businesses -- the very engine of job creation and innovation and the backbone of his or her local community -- which has suffered most. Compounded with nearly $2.2 trillion in commercial real estate loans coming due over the next decade, and a very limited capacity to refinance, the sales and leasing of commercial properties have been dismal, hindering our nation's economic recovery. Failing to reauthorize the NFIP long-term not only exacerbates the market uncertainties but also could leave many commercial property owners, many of whom are struggling to stay afloat due to high vacancy rates and lower net operating incomes, without access to affordable flood insurance. The lack of available, affordable flood insurance for property owners, in many cases, would hold up the sale of commercial properties, further contributing to the economic crisis.

*Flood Mapping Reforms*

The Senate bill would have:

- Established a Technical Mapping Advisory Council to review and make recommendations for more accurate flood insurance rate maps; such maps are used to determine which properties are located in "Special Flood Hazard Areas" (SFHAs) and thus subject to the mandatory purchase of flood insurance.

- Directed FEMA, in coordination with the Council, to update the flood maps and include the 500-year floodplain and the areas of residual risk (behind levees, dams or other man-made structures) in addition to the 100-year floodplain.

*NAR Comments*: FEMA recently completed a 10-year map modernization initiative to update the flood maps. These updates capitalized on major advances in modern flood mapping technologies including LIDAR and satellite imaging. While survey data shows only a fraction of property loans (e.g., <3% in 2009) were affected by these revisions and of those affected, about as many were removed from SFHAs as the reverse, concerns continue to be raised about the accuracy of these maps.[20]

NAR generally supports efforts to improve the accuracy of the flood maps. Reestablishing the technical mapping advisory council of independent experts would help strengthen the scientific integrity underpinning these maps and increase confidence in their development. We also believe that to effectively meet its charge, the Council must include a real estate expert as a member.

At the same time, we would oppose expanding flood maps to include areas outside of the 100-year floodplain. The very inclusion of bill provisions to improve map accuracy implies that at least some maps are not now accurate. If so, FEMA should focus its limited resources on drawing an accurate 100-year floodplain before being required to redraw and expand the boundaries to include the 500-year floodplain or residual-risk areas. (Please note the latest House Committee bill (H.R. 1309) originally included a provision to also delineate the 250-year floodplain, but that provision was struck during the markup.)

In most cases, the resolution and thus accuracy of the mapping technologies significantly improved. Yet, there may still be a few exception areas where the resolution was not sufficient to detect some properties that sit on natural ground above the 100-year floodplain or a property may also have been built on fill material after FEMA's modernization project began. In either case, such property owners may appeal, which would require analysis and documentation by an engineer that could be time consuming and expensive. Risk determinations would be made based on sound technical assessments involving engineering, topography and hydrology. We would encourage the Senate to include provisions to streamline the flood map appeals process to address any inaccuracies in a flood map. The House Committee also amended its bill to provide for the reimbursement of expenses in the event of a successful map appeal, and we would encourage the Senate Committee to consider including a similar provision in its bill as well.

*Newly Flood Mapped Areas*

The Senate bill would have subjected areas of residual risk (behind levees, dams, and other manmade structures) to the mandatory purchase of flood insurance requirement.

*NAR comment:* FEMA has not been able to assure the accuracy of the boundaries it's drawn around the 100-year floodplain. Directing FEMA to expand these boundaries now would only compound the problem. In addition, there are numerous smaller levees, berms and other structures all over the country that could be considered flood control structures, which would diminish the flood risk and therefore the insurance rate to be charged. We are not aware of any assessment of these structures or the economic impact of expanding the mandatory purchase requirement to property owners near them. We would not recommend including these provisions in the latest bill. Before proceeding, GAO should conduct a study of the number of flood control structures, the average premium that would be charged behind these structures and the resulting economic impact on property owners.

The House Committee bill also included authority for FEMA to suspend for 12 months (and extend for up to two more 12-month periods) the mandatory purchase requirement for communities which

20 Communication with National Flood Determination Association, May 24, 2011. Based on NFDA's annual surveys from 2006 to 2010, which represent 94% of the market that completes flood zone determinations.

are newly included in the 100-year floodplain but where the area has had no flood history; was in the process of appealing the new map; or been making progress toward improving a structure that protects against flooding such as a levee or dam.

We believe it reasonable to delay the flood insurance mandate while the communities work through appeals over inaccurate maps, and we would respectfully request the inclusion of similar provisions. Otherwise, property owners could be forced to purchase flood insurance only to find months later that the requirement was a mistake. Then these owners would be in the position of having to seek reimbursement for the purchase of insurance they never should have been required to purchase in the first place.

We would also request that the Committee streamline the flood map appeals process for communities as well as individuals. Currently, individual property owners may face significant transaction costs in coordinating appeals across properties and have little choice but to turn to the community. Community appeals could involve considerable tax dollars to hire the experts necessary to conduct and make the reasonable judgments that go into a dueling engineering study with FEMA's. If FEMA's mapping process is inaccurate, the burden should be placed back on FEMA to correct the maps—not shifted forward to the property owners or communities that have been incorrectly drawn into the 100-year floodplain.

*Premium Rate Reforms*

The Senate bill included provisions to:

- Authorize an annual premium increase of up to a maximum of 15% per year.
- Set minimum deductibles for newer and older properties.
- Phase-in the full actuarial rate by 50% per year over two years for properties in newly flood mapped areas.
- Phase-in the full rate (by 25% a year until the full-risk rate is achieved) for older properties including:
    - Business Properties;
    - Non-primary Residences;
    - Homes Substantially Damaged or Improved; and
    - Severe Repetitive Loss Properties.
- Prohibit the extension of subsidized rates for new or lapsed NFIP policies.
- Direct FEMA to include "catastrophic loss years" in calculating the "average historical loss year;" FEMA sets the premium rates annually to cover this average.
- Establish a Reserve Fund for catastrophic loss years to be funded by a surcharge on flood insurance policies.

*NAR Comments*: In order to preserve the federal flood insurance program into the future, the real estate sector recognizes the need for everyone to shoulder their fair share, even if it means paying a little more. The severe repetitive loss properties, accounting for 1% of NFIP properties but 30% of claims, are a particular budgetary challenge for the NFIP. Therefore, we would strongly support charging such properties the full actuarial rate. However, we would continue to have concerns with applying these provisions to other older properties where there has been no history of flood loss or change in risk.

Congress grandfathered older properties under a lesser rate because it was believed to be better to include these properties in a program where they could be strengthened against future flood loss, even if it meant they paid a little less. This was so that the U.S. taxpayer would not ultimately end up footing the bill for rebuilding those properties after the next flood. Under the Senate bill however, these owners, who may have been contributing considerable premium dollars to the NFIP for decades, would now have to pay significantly more, not because there has been a flood loss or even a change in their flood risk; but rather because the property is not the owner's primary residence (i.e., it's a business property or non-primary residence).

According to FEMA, on average, premiums charged for subsidized policies are about 35-40% of their full-risk level. Thus the average premium would have to increase to about two and a half times the current level under the proposed increase. This is for the average premium; some properties could see the premium increase more than four-fold. There is a limit to the amount that the insurance, or any other expense, may increase before owners are either forced to sell their properties, or go without insurance. This would have a particularly severe impact on the cost of home ownership and rents, especially in older communities and those that rely on tourism. This could lead to additional rounds of delinquencies, foreclosures and reduced property tax bases in these communities.

While we continue to have concerns about the affordability of the proposed insurance rates for older properties, particularly those with no history of flooding or change in risk, at minimum, we would respectfully request that the Committee:

1) Phase-in any rate increase more gradually than the last Senate bill so that every owner has an opportunity to adjust to the increases and no one has to shoulder the entire increase in a single year. (Note: The House bill would phase-in the full rate for most of the older properties over at least a 5-year timeframe.)

2) Provide the same gradual phase-in for all categories of older and newly mapped properties that are subject to a rate increase. Every affected owner should have the same opportunity to adjust.

3) Separate out multi-family rental properties of four or more units from the non-residential properties and exclude them from the phase-in, due to affordability concerns. For the renter, the apartment or house in which he or she is living is the primary residence, but could be considered either a commercial property or a non-primary residence because it is non-owner-occupied. Thus, if the discounted rate were eliminated, tenants would face rent increases that would have a dramatic effect on housing affordability, especially in the case of low and fixed-income individuals and families.

4) Continue to include comprehensive coverage for all properties, including multi-family housing, non-primary residential and commercial properties.

5) Not adopt "back-door" rate increases for NFIP property owners. Requiring FEMA to recalculate the "average historical loss year" to include "catastrophic loss years" is simply another way to raise rates, except this way would be less transparent to the property owner. This is because FEMA sets premium rates to cover losses in the historical average year. By including outlier years in this calculation, as this amendment would, this would inflate the amount the rate would have to cover and therefore the rate itself. We believe that a reserve fund is a more straightforward way to offset the losses in catastrophic years (for more on the bill's reserve fund provisions, please see below).

6) Study the impact of any rate phase-in on pre-FIRM properties so that the Congress would have a basis to evaluate and adjust the phase-in as necessary.

While we would support establishing a reserve fund to cover above-average loss years, we would like to work with the Committee to ensure that such a fund would not reduce voluntary NFIP participation. The last Senate bill would have required FEMA to build up the fund by annually putting in hundreds of millions of dollars until an amount numbering in the billions was reached. As a result, FEMA would have had to raise rates somewhere in order to meet this annual quota, however it could not have looked to property owners who were already experiencing rate increases near the annual limitation. Instead it would have had to look those who were voluntarily participating in the program which could undercut future participation. We encourage Congress to ensure that all participants are treated fairly and equitably as the reserve fund is created.

*Coverage Term Reforms*

The latest House Committee bill would provide optional coverage for business interruption and living expenses at the full actuarial rate and only if there is not a market for the coverage and it will not lead to additional borrowing. Adding these options to the Senate bill would attract new NFIP participants. That would lead to increased funds for the NFIP, help property owners recover from flood losses and decrease future federal assistance when under-insured properties flood and suffer loss. It would also help increase protection for home- and small-business owners. Increasing or indexing the maximum coverage limits, also as the House committee bill would, would ensure these limits more accurately reflect the increases in property and contents values and provide fuller coverage to policyholders. These limits have not been adjusted despite inflation since 1994. We would ask the Committee to consider including these provisions.

*Privatization Initiatives*

The House Committee bill includes studies by FEMA and GAO to begin the process of privatizing the NFIP after the 5-year reauthorization. The last Senate bill did not include such provisions.

*NAR Comments*: NAR is adamantly opposed to any effort to move the NFIP towards privatization, including a pilot program or other initiative. We established in previous sections that the private market could neither guarantee the availability nor the affordability of property insurance to protect against flooding, one of the most expensive natural disasters in the United States. Privatizing the NFIP would only remove a sole alternative to taxpayer-funded government payments for rebuilding after a major flood. Now is not the time to experiment with real estate markets that are recovering from the worst economic downturn since the Great Depression. We urge the Committee not to include similar provisions in a Senate bill.

*Natural Disaster Commission*

The Senate version of H.R. 3121 in the $110^{th}$ Congress included provisions to establish a commission on natural catastrophe risk management and insurance. This commission would be charged with examining the risk to the United States posed by a broader range of natural disasters (other than floods) and to make recommendations to Congress for mitigating the risk.

*NAR comment*: We applaud the Senate for including this commission in its last NFIP reform bill. As stated earlier, today the United States lacks a forward-looking and comprehensive public policy toward natural disasters, except floods, and is one natural disaster away from a budgetary nightmare. REALTORS® strongly believe that ensuring access to affordable property insurance for all natural disasters is an indispensible component of any forward-looking policy. Such a policy has the potential to save billions of taxpayer dollars annually by shifting the costs of rebuilding under-insured communities following a natural disaster back to affected property owners who would now have been able to buy insurance and protect themselves in advance of these disasters. NAR strongly supports these commission provisions and would encourage the Committee to include them in its version of NFIP reform legislation.

## Conclusion

In summary, the NFIP fills a void in the private market for critical insurance protections against flood losses which benefit the nation as a whole. While the Committee is facing difficult reform choices, proceeding is preferable to the current month-to-month stop-gap extension approach which has only undermined confidence and exacerbated uncertainty in recovering real estate markets. Thank you again for the opportunity to share the REALTOR® community's views on the importance of the NFIP. NAR stands ready to work with the Committee to develop meaningful reforms to the NFIP that help protect property owners and renters and help them prepare for and recover from future losses resulting from floods.

**Table. Ranking of States By Number of Net-Loss Years**

| State | Number of Years that Claims & Expenses Exceeded Premiums 1978-2009 |
|---|---|
| Minnesota | 13 |
| Missouri | 13 |
| Ohio | 13 |
| Louisiana | 12 |
| Mississippi | 12 |
| West Virginia | 12 |
| Alabama | 11 |
| Illinois | 11 |
| Texas | 11 |
| Arkansas | 10 |
| Kentucky | 10 |
| New York | 10 |
| Indiana | 9 |
| North Dakota | 9 |
| Oklahoma | 9 |
| Tennessee | 9 |
| Washington | 9 |
| New Hampshire | 8 |
| Connecticut | 7 |
| Kansas | 7 |
| North Carolina | 7 |
| Pennsylvania | 7 |
| South Dakota | 7 |
| Virginia | 7 |
| Massachusetts | 6 |
| Delaware | 5 |
| Georgia | 5 |
| Iowa | 5 |
| Maine | 5 |
| Maryland | 5 |
| District Columbia | 5 |
| Michigan | 5 |
| Montana | 5 |
| New Jersey | 5 |
| Rhode Island | 5 |
| Wisconsin | 5 |
| Arizona | 4 |
| California | 4 |
| Florida | 3 |
| Hawaii | 3 |
| Nebraska | 3 |
| Utah | 3 |
| Nevada | 2 |
| Oregon | 2 |
| Vermont | 2 |
| Wyoming | 2 |
| Alaska | 1 |
| Idaho | 1 |
| South Carolina | 1 |
| Colorado | 0 |
| New Mexico | 0 |

Figure 1: Number of Major Flood Disaster Declarations by County, 1980-2005

# REAUTHORIZATION OF THE NATIONAL FLOOD INSURANCE PROGRAM—PART II

**THURSDAY, JUNE 23, 2011**

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

The Committee met at 10:06 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

## OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. I would like to call this hearing to order.

This is the Committee's second hearing to examine the reauthorization of the National Flood Insurance Program. At our first hearing on June 9, we had a good discussion of this topic with FEMA Administrator Craig Fugate. Today, we are joined by a panel of experts and stakeholders who will share their perspectives on reauthorization.

The Flood Insurance Program was created to help communities limit damage and recover more quickly. Flooding is responsible for more damage and economic loss than any other type of natural disaster. I need to look no further than my own home State for a reminder of this, as we battle historic flooding along the Missouri River in South Dakota. South Dakotans have shown tremendous hard work and community spirit in this fight, but are understandably concerned about the road ahead. I want to state again that I will do my best to get them the help they need now and when the water recedes.

Despite the Flood Insurance Program's importance, it now faces challenges to its long-term viability. Over the past year, we have also had several disruptive lapses in the NFIP. I hope we can provide greater certainty to the program through a long-term extension with much needed reforms.

This recent flooding is another reminder that Congress must reauthorize the NFIP before the upcoming September 30 expiration date. As I said during our previous hearing, I hope that we can once again come together and pass a bipartisan bill that will build a sustainable future for the program and American citizens. I look forward to hearing from our witnesses on this subject.

Senator Shelby is not here, but I will now open it up to all Committee Members who wish to give an opening statement. Before that, I ask unanimous consent for the record to remain open for 7 days for additional statements and questions.

Does anybody want to give an opening statement? Senator Johanns.

Senator JOHANNS. Mr. Chairman, as you know, our normal practice is to let the Chair and Ranking Member speak. I do have an opening statement, but I am guessing all of my colleagues would like to get to the witnesses. We have a long panel here. I am willing to submit my opening statement for the record and just call it good and get ready to hear from the witnesses.

Chairman JOHNSON. Anybody else?

[No response.]

Chairman JOHNSON. With that, I would like to introduce today's panel. Before I begin, I would like to note that we have invited several additional organizations representing the insurance industry to submit written testimony for the Committee today. I will submit additional statements from the Property Casualty Insurers Association of America, National Association of Mutual Insurance Companies, American Insurance Association, and the Independent Insurance Agents and Brokers of America, and others into the record. I encourage my colleagues on the Committee to review this testimony.

Now, I will introduce today's panel. Our first witness today is Ms. Orice Williams Brown, who is the Director of the Office of Financial Markets and Community Investment at GAO. Ms. Brown has led extensive reviews of the National Flood Insurance Program and is no stranger to this Committee. I would like to welcome her back.

Mr. Chad Berginnis is the Associate Director of the Association of State Floodplain Managers. He has spent over 15 years in floodplain management, hazard mitigation, and land-use planning at the State and local levels and in the private sector.

Mr. Adam Kolton is the Executive Director of the National Advocacy Center at the National Wildlife Federation, and is also testifying as a representative of the Smarter Safer Coalition.

Mr. Barry Rutenberg is a home builder with more than 35 years of experience in the building industry. He is currently the First Vice Chairman for the National Association of Home Builders.

Mr. Travis Plunkett is the Legislative Director for the Consumer Federation of America, a nonprofit association of over 280 organizations that advances consumer interests.

Finally, we will hear from the Honorable Scott H. Richardson. Mr. Richardson has previously served as South Carolina's Insurance Commissioner as well as a State Legislator. He is currently a partner in Richardson and Ritchie Consulting.

Welcome, everyone. Ms. Brown, please begin.

## STATEMENT OF ORICE WILLIAMS BROWN, DIRECTOR, OFFICE OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT, GOVERNMENT ACCOUNTABILITY OFFICE

Ms. BROWN. Chairman Johnson and Members of the Committee, I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program. As you know, floods are the most frequent natural disasters in the United States, causing billions of dollars of damage each year.

Congress originally created the National Flood Insurance Program to address the lack of readily available insurance for property owners and growing costs to the taxpayer for flood-related disaster relief. This morning, I would like to share my thoughts about three issues: The program, possible reform options, and FEMA's management challenges.

First, NFIP serves a vital role in providing protection against flooding to over 5.5 million policyholders nationwide. As you know, NFIP is one of 31 programs or issues designated by GAO as high risk in 2011. NFIP first appeared on this list in March 2006, after the 2005 hurricane season exposed the potential magnitude of longstanding structural issues on the financial solvency of the program and brought to the forefront a variety of operational and management challenges that must also be addressed to help ensure the long-term stability of the program.

Second, using the broad public policy goals identified by GAO in our past work on the role of the Federal Government in providing natural catastrophe assistance, I will share some thoughts on reforming NFIP. These broad goals include charging rates that reflect the risk of flooding, limiting costs to taxpayers, encouraging broad participation, and encouraging private sector involvement.

As you know, successfully reforming NFIP will require tradeoffs among these often competing goals. For example, currently, nearly one in five policyholders does not pay a full risk rate and others pay grandfathered rates. Past reform efforts have included phasing out these rates. Phasing out of rates not only results in rates that reflect the risk of flooding, but also can help minimize costs to the taxpayers and could help encourage private sector participation. The tradeoff involves potentially losing some policyholders who may opt to leave the program, potentially increasing post-disaster Federal assistance. However, these challenges can be overcome by a variety of options, including targeted subsidies, vouchers, tax credits, and mitigation.

The goal of encouraging broad participation in the program could be achieved by increasing targeted outreach to help diversify the risk pool. One way for FEMA to do this is to make sure its incentive structure is consistent with its goal of expanding participation in low-risk zones, in areas subject to repeated flooding, but have low penetration rates, among others.

Encouraging private markets is one of the more difficult challenges because there is currently no broad-based private market for flood insurance for most residential and commercial properties. As originally envisioned, NFIP was established as a cooperative arrangement between the Federal Government and the private sector, with both assuming some of the risk. The private sector withdrew from the program because of the lack of flood risk data, maps, and relevant building codes. Given that these issues have largely been addressed, private sector involvement warrants consideration. FEMA has been reaching out to the industry to find ways to involve the private sector in the program, including exploring reinsurance and other ways to share risk.

Third, beyond reforming the program, FEMA must take steps to improve its management of NFIP. In our most recent report, we found issues in strategic planning, human capital planning, intra-agency collaboration, records management, and information technology. While FEMA continues to make some progress in addressing certain areas, fully addressing these fundamental issues will be vital to the long-term operational efficiency and stability of the program.

Finally, I would like to offer a few other areas that warrant consideration as the reform discussion continues, for example, mitigation programs and ways to make them more effective, including clarifying FEMA's authority to charge higher rates when property owners refuse to or do not respond to mitigation offers, or allowing FEMA to apply a surcharge when mitigation offers are refused; full-risk rates and whether catastrophic losses should be included; appropriating for any subsidies until the full-risk rates are fully phased in; and authorizing FEMA to map for all present flooding risk, including erosion.

Thank you, Chairman Johnson and Members of the Committee. This concludes my oral comments and I am prepared to answer any questions at the appropriate time. Thank you.

Chairman JOHNSON. Thank you.

Mr. Berginnis.

**STATEMENT OF CHAD BERGINNIS, ASSOCIATE DIRECTOR, THE ASSOCIATION OF STATE FLOODPLAIN MANAGERS**

Mr. BERGINNIS. Good morning. Today, our country is facing significant flooding. We have all paid attention to flooding that has occurred on the lower Ohio and Mississippi Rivers earlier this year, snow melt concerns in the Dakotas, and now much of the Western U.S. is being impacted by a combination of storm events and record snowpack. Levees are overtopping and critical infrastructure, including two nuclear power plants, are in this year's flood's devastating path. Of the 44 Federal Disaster Declarations in only the first 6 months of this year, 31 are at least partially due to flooding.

Chairman Johnson and distinguished Members of the Committee, I am Chad Berginnis, Associate Director of the Association of State Floodplain Managers. Our organization of over 14,000 members and 30 State chapters include State and local government officials, private sector companies, and other interested parties that are on the front line each and every day working to reduce flood losses.

While the ASFPM believes that the NFIP has shown success—since the inception of the program, it has paid nearly $37 billion in claims—compliance with basic land-use standards of the NFIP now results in $2 billion in losses avoided every year, with buildings not constructed to NFIP standards having a likelihood of flooding five times higher than those built to those standards. Flood losses continue to increase, jumping from an average of $6 billion annually to nearly $10 billion annually in the most recent decade.

To put these data in perspective, it is important to understand that the NFIP is one tool and one program among many that have an impact on flood losses in this country. The NFIP has shown tangible success and has had a significant impact in reducing flood losses, and the program has been in existence for 43 years and there is sufficient program knowledge and experience to improve it.

Our written testimony contains 13 actionable recommendations that can be incorporated into an NFIP reform bill. These recommendations focus on a variety of longstanding and known issues, including fiscal solvency, hazard identification, hazard mitigation to deal with the built environment, and future challenges, such as sea-level rise. I am going to spend the balance of my time highlighting these recommendations.

First, we must have an authorized ongoing national mapping program that addresses all the significant flood hazards. Here we are in 2011, 43 years into a program that insures $1.4 trillion in property, and flood risk rating and hazard identification are based on mapping funds largely coming from user fees and, more recently, some dedicated appropriations, yet we do not have a long-term authorized program.

Second, while land-use and building standards are necessary to ensure new development is resilient in the unbuilt environment, we must have equally strong mitigation programs to address existing risk in the built environment. We think Congress has been on the correct path since 1994, when it first recognized this issue and created programs within the NFIP to help existing at-risk structures, including repetitive loss properties. These programs will be increasingly important, especially if measures to create a more actuarially sound program compel property owners to mitigate their properties or face significantly higher flood insurance premiums. The Severe Repetitive Loss Program should be reauthorized, or better yet, could be reauthorized and combined with other existing flood mitigation programs for efficiency.

There should be a balanced and rational resolution to the actuarial soundness and policy affordability issue. From a risk communication standpoint, a significant failure of the program is the policy premium bill, when sent to a policy owner, reflecting a cost that is significantly less than the true risk. We agree that the program needs to be more actuarially sound, and moving certain classes of properties to actuarial risk rating makes sense.

In the last decade, when Congress has debated this issue, concerns have been raised about those who cannot afford the premium increase, yet the program subsidy continues to be based on data construction of building *versus* the ability of a property owner to pay flood insurance. Recent ideas in this area, such as means-tested voucher systems, have merit and should be explored.

The purchase of flood insurance in residual flood risk areas should be mandatory. Even as this hearing is occurring, flooding is happening in areas behind levees and downstream of dams that are not mapped as flood hazard zones. Flood risk does not stop at the 100-year flood boundary.

And finally, we think that the debt of the NFIP must be forgiven. FEMA has testified that the debt cannot be repaid, even if we hold our collective noses to do it. We would argue that the program simply worked as designed in the years when the debt accumulated.

In closing, I am sad to report that the flood problem this year and in the future is going to get worse before it gets better. The Western snowpack has only begun to melt, and with hurricane season around the corner, we have a lot to contend with.

That concludes my oral testimony. I will be happy to take questions. Thank you.

Chairman JOHNSON. Thank you.

Mr. Kolton.

**STATEMENT OF ADAM KOLTON, EXECUTIVE DIRECTOR, NATIONAL ADVOCACY CENTER, NATIONAL WILDLIFE FEDERATION, ON BEHALF OF THE SMARTER SAFER COALITION**

Mr. KOLTON. Good morning, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. I am Adam Kolton and I direct the National Advocacy Center at the National Wildlife Federation. I am pleased to be here to speak on behalf of our four million members and supporters across the country, 47 State affiliates. We commend you for having this series of hearings, especially in light of the record-breaking floods in the Mississippi and Missouri River basins and elsewhere in the country.

I am also here today to speak on behalf of the Smarter Safer Coalition, which includes taxpayer and free market groups, insurance and reinsurance interests, housing advocacy groups, and other conservation groups. Mr. Chairman, I am sure you can appreciate that it is not every day that groups like the National Wildlife Federation finds itself in agreement with Americans for Tax Reform, but on this issue, we stand together.

Our collective view is that the NFIP is broken and in desperate need of reform. Smarter Safer has collaborated on a reform proposal, which is included with my written testimony. Let me hit a few of the high points of those recommendations.

First, we need more accurate scientifically valid flood risk maps. Accurate maps can help ensure that people understand the risk of where they live, that premium rates reflect risk, and to encourage risk reduction strategies. Without accurate science-based maps, the NFIP will not work and cannot be fixed. Smarter Safer proposes that Congress create a Technical Mapping Advisory Council similar to the version in the Committee's 2008 reform legislation. The Council would develop new standards for flood insurance maps that would incorporate true risk, be graduated, and reflect realities on the ground, both manmade and natural. Such a council should include representatives from Federal agencies as well as experts with technical expertise in mapping natural and beneficial floodplain functions. The work of this Mapping Council can address many of the concerns raised by Members of this Committee, including what level of protection is afforded by existing structures, levees that are in place, the extent to which upstream issues are exacerbating downstream flooding, and ensuring that maps are scientifically valid.

Second, rates must reflect actual risk. Currently, the NFIP insurance rates do not reflect actual risk of flood damage, effectively subsidizing floodplain development and encouraging properties to be located in harm's way. Smarter Safer encourages the Committee to move all rates to actuarial within a 5-year period. The Committee made a good start at this in the 2008 bill. However, in light of recent conditions and the exploding deficit, we urge the Committee to move the entire program, including prefarm properties, to risk-based rates. Right now, million-dollar homes receive the same subsidies as properties valued at $100,000. That makes no sense.

For those truly unable to afford rate increases, Smarter Safer does support means-tested subsidies, but that are not linked to the rate structure.

Third, mitigation and risk reduction must be a central NFIP priority. It is imperative that NFIP finally fulfill one of its original stated goals, to encourage the mitigation of flood risks. This can be done by strengthening existing FEMA grant programs and improving incentives in the community rating system which rewards communities with lower insurance premiums in return for taking concrete steps to reduce flood risk. In addition, Smarter Safer believes FEMA should be encouraged to work directly with individuals for mitigation where communities lack the capacity to do so, and FEMA should prioritize Severe Repetitive Loss properties for buyout.

Now, let me emphasize an important point. Every dollar spent on mitigation yields $4 in avoided—a return of $4 in avoided losses. These programs can pay for themselves, as CBO has noted.

Now, two points of particular concern to the National Wildlife Federation. First, it is important to recognize that these are not normal times. The climate is changing and we are experiencing more intense storms, sea-level rise, and extreme flooding. According to NOAA, big storms seen typically once every 20 years will occur every 4 to 6 years by the end of this century. We are already seeing an upsurge in the number of heavy rainstorms and many other impacts.

As this Committee looks to reform the NFIP, it is important that we look to the future and not in the rear-view mirror. We need to prepare America, and FEMA needs to plan for and factor in the increased risk the way private insurers and reinsurers already are.

Second, nature's infrastructure, healthy intact wetlands and floodplains, is the best flood protection money can buy. By working to reconnect rivers with their floodplains where possible and discouraging development where intact floodplains exist, the NFIP, together with other Federal, State, and local programs, can provide some of the best possible flood protection. What is more, healthy floodplains sustain countless fish and wildlife species, improve water quality, and support hunting, fishing, and outdoor recreation opportunities. In short, any meaningful reform effort must ensure that the natural beneficial functions of floodplains are recognized and that building, dredging, filling, and walling off floodplains is prevented to the maximum extent possible.

This is an historic moment. We are hopeful that the Committee can, on a strong bipartisan basis, move forward a comprehensive NFIP reform bill that better protects people, communities, and the environment all across the country. Thank you.

Chairman JOHNSON. Thank you.

Mr. Rutenberg.

**STATEMENT OF BARRY RUTENBERG, FIRST VICE CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS**

Mr. RUTENBERG. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify today. My name is Barry Rutenberg and I am a home builder from Gainesville, Florida, and First Vice Chairman of the Board for the National Association of Home Builders.

NAHB commends the Committee for addressing reform of the NFIP Program. NAHB wants to make clear that we strongly support a 5-year program reauthorization. Builders see this as the best way to provide a steady foundation on which to build program revisions and ensure the NFIP is efficient and effective.

For several years, the NFIP's short-term extensions have created a high level of uncertainty in the program, causing severe problems in an already troubled housing market. During these periods, there were delays or canceled closings due to the inability to get flood insurance for mortgages. Often, new home construction was shut down or postponed due to the lack of flood insurance approval, adding unneeded delays and job losses. NAHB believes reauthorization will ensure the Nation's real estate markets operate smoothly and without delay.

The availability and affordability of flood insurance gives local governments the ability and flexibility to plan and zone their communities, including floodplains. These zoning standards allow homeowners the opportunity to live in a home and location of their choice, even when their home lies in or near a floodplain. And long-time landowners and builders depend on the NFIP to be annually predictable, universally available, and fiscally viable.

The NFIP creates a strong partnership with States and localities by requiring them to enact and enforce floodplain management measures, including building requirements designed to ensure occupant safety and reduce future flood damage. This partnership depends upon the availability of up-to-date flood maps and a financially stable Federal component and allows local communities to direct development to the needs of the constituents and consumers.

Unfortunately, the losses and devastation suffered with the 2004 and 2005 hurricanes has severely taxed and threatened the solvency of the NFIP. While these tragedies have exposed shortcomings in the NFIP, we believe that reforms to the program must not be an overreaction to the historic circumstances. The NFIP is not just about flood insurance premiums and payouts. It is a broad program that guides future development and mitigates against future loss. A financially stable NFIP is in all of our interests, and Congress's efforts have the potential to greatly impact housing affordability and the ability of local communities to control their growth and development options.

A key tool in the NFIP's implementation, the rate maps, or FIRMs, have been recognized by Congress to be inaccurate and out of date. FEMA has been successful in digitizing most of the FIRMs, yet many of the maps are not using updated data, and because of this, large discrepancies remain. We believe continued Congressional oversight is necessary. We commend the House bill's efforts to create the Technical Mapping Advisory Council and hope to see it in the law.

Beyond fixing the maps, NAHB also supports increasing coverage limits to better reflect replacement costs and offering various insurance options for consumers and even a possible minimum deductible increase. The NFIP must continue to allow State and local governments, not the Federal Government, to dictate local land-use policies and make decisions on how private property may be used.

FEMA must also better coordinate its activities with other Federal agencies who have oversight of other Federal programs. In my written statement, I discuss FEMA's recent requirements of ESA compliance for certain property owners.

Additionally, before any reforms are enacted to change the numbers, location, or type of structures required to be covered by flood insurance, FEMA should first demonstrate that the resulting impacts on property owners, communities, and local land use are more than offset by the increased premiums generated and the hazard mitigation steps taken. NAHB urges Congress to ensure construction requirements remain tied to the 100-year standard, as in the current House bill. Should Congress change the Special Flood Hazard Area from a 100-year standard to a 500-year standard, it would require more homeowners to purchase flood insurance and could impose mandatory construction requirements that increase cost, impact land use, and resale values. It could seriously diminish the value of long-time landowners in the agricultural field and others in their options. This would also affect FEMA by requiring modification to ordinances and policies, all at a time when FEMA has admitted its lack of resources to provide current services.

I thank you for today, and NAHB looks forward to working with the Committee on this valuable program.

Chairman JOHNSON. Thank you.

Mr. Plunkett.

**STATEMENT OF TRAVIS B. PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA**

Mr. PLUNKETT. Good morning, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. I appreciate the invitation to appear before you today to discuss how to reform and reauthorize the National Flood Insurance Program. I am Travis Plunkett. I am the Legislative Director at the Consumer Federation of America.

The NFIP is in very deep trouble. Its mission is crucial, as we have seen recently by the devastating floods in the South and the Midwest, but it has been struggling financially for years and is failing to achieve an essential goal of this mission, and that is to protect home and business owners by achieving safe construction in the floodplains and by ensuring that flood insurance is actuarially priced to account for the full risk of the coverage that is offered.

To fix the long-term structural flaws that are harming consumers and taxpayers, we recommend, first, that you use legislation reported out of the Committee on a bipartisan basis in 2007 as the starting point for improving and extending the program for no more than 2 years beyond its expiration this September.

Second, we strongly suggest requiring the completion of a study within 18 months that would examine more far-reaching measures to either permanently correct the deep-seated flaws in the NFIP, such as getting private insurers to assume substantial flood risk, or to phaseout the program in a responsible manner and create effective, affordable alternatives.

The third step in this process would be to enact legislation that addresses these broader recommendations.

Why would a consumer group support reforms of the NFIP that will likely raise rates for some consumers? The answer is that underpricing of flood risk and poor management of the NFIP by FEMA subsidizes dangerous construction, threatens the safety and property of home and business owners, and often benefits those who need the assistance the least, affluent homeowners and builders.

Look at what happened in Hancock County, Mississippi, where Hurricane Katrina hit ground. The average flood map, according to Bob Hunter, our Insurance Director's study, of the 76 flood maps that existed in that county, the average was 20 years old and ten feet too low in measuring the 100-year flood elevation. Many home and business owners were misled into building unwisely, or into not buying needed insurance, exposing the deeply flawed program's weaknesses in the most tragic way.

The current patchwork of indiscriminate, counterproductive, and often hidden subsidies drains the NFIP of resources and should be phased out. Congress should use the money that it saves by eliminating these general subsidies to target aid to low- and moderate-income home and business owners who have difficulty affording flood insurance.

Of particular concern to us right now is FEMA's management of the "Write Your Own" Program, in which private insurers offer flood policies but do not underwrite flood risk. This program overcharges taxpayers and is riddled with conflicts of interest. GAO studies have repeatedly demonstrated that these private insurers overcharge for administrative and claims settlement duties and that FEMA has mismanaged the program. An urgent task is to quickly fix the Write Your Own Program. It will reduce costs. It will allow the program to have more money for other, more important tasks, and it will benefit policyholders.

The time has come for Congress to consider either far-reaching, long-term changes to permanently fix problems in the program or to end the program. We would like to see a very far-reaching study on a number of important questions. How do you encourage private insurers to take some or all of the existing flood risk? How do you end broad subsidies that disproportionately benefit the affluent? How do you provide low- and moderate-income policyholders more targeted assistance and increase the number of people buying flood insurance in flood-prone areas? How do you improve the flood maps and the construction in local communities?

While GAO or other bodies are studying these long-term changes, we would urge the Committee to reauthorize the NFIP for no more than 2 years and take initial steps to reform it along the lines of the Senate Flood Insurance Reform and Modernization Act of 2007. The bill takes several very important steps to protect consumers and taxpayers, to increase market penetration of flood insurance, and to eliminate unjustified subsidies of the flood program. Thank you very much.

Chairman JOHNSON. Thank you.

Mr. Richardson.

**STATEMENT OF SCOTT H. RICHARDSON, POLICY ADVISOR, THE HEARTLAND INSTITUTE, AND PARTNER, RICHARDSON AND RITCHIE CONSULTING**

Mr. RICHARDSON. Yes. Thank you, Chairman Johnson, Ranking Member Shelby——

Chairman JOHNSON. Turn on your microphone.

Mr. RICHARDSON. I am sorry. I ought to know how to do that after 15 years in the legislature.

[Laughter.]

Mr. RICHARDSON. Mr. Chairman, Ranking Member Shelby, and other Members of the Committee, thank you very much for this opportunity. I have written testimony, which I am going to digress from a little because what I am speaking to you about today is a more rifle shot part of this process that you are dealing with.

But I also want to give two general statements as I talk about this process today, two thoughts that I think the members should always think about whenever you are dealing with insurance, and that is you must vote for whatever makes insurance more predictable and you must think to vote to what makes insurance more consistently available, and that is a huge issue with the flood program because it is inherently unpredictable, and it has been for the last 30 years, traditionally inconsistently available. So as you look forward in this process and the amendments that you consider over the next weeks and months, I would ask you to just take those two litmus tests and remember that every time you look at it.

I am here today to talk about primarily Senator Wicker's amendment, which I very much appreciated. It is a subject I have been working on for several years, the problem of what we call indeterminate loss and how it affects the Flood Insurance Program, consumers, companies, and others, and I want to speak briefly and just tell you that I have been an insurance agent and broker for almost 30 years. I have been a legislator. I have been the Director of the Department of Insurance, so I have sort of a unique look at all of this from all sides and have been through hurricanes, experienced many of my customers in Hurricane Hugo and others. So I have seen nothing but concrete slabs where there were beautiful homes. I have been there on the ground and I know what can happen here.

But the indeterminate loss problem is that which when you have a huge storm and you basically have no evidence to show you what was wind and what was water, you create a big problem, not only for the Flood Insurance Program, but for the whole insurance system. Insurance companies, it becomes unpredictable for them. They are selling a policy that legally has no flood insurance in it. You have State wind pools who have regulations that have very specific things that are in their policies and are not in their policies. You have a National Flood Insurance Program involved that covers only flood. And you have to mold these things together. So that blimp-eye view, I think, is important, and as the other panel members have mentioned many other aspects that become important to the flood, the mapping, the rating, and all of these things.

But insurance, as we do this, the National Flood Insurance is a very, very important undergirding of the whole business system that we have in this country, from my point, especially on the coast. I mean, insurance itself is the real provider for why we can do things in a big way in this country that we could not do otherwise. Otherwise, if you had to pay cash for your car, for your house, for your office building, there would be very little done in this country. So I think we all have to, as we work toward this, get to my premise of it must be predictable and it must be consistently available.

Now, going to the specific point, as I said, about indeterminate loss, this is a problem whereby we would create a system that we can—we have the scientific data to do so. We would create formulas in the special loss allocation system where when you do not have the evidence to do it, you will have extrinsic evidence. You will have scientific formularies that you can put into a statistical model that will tell you how to predict the loss. I think this is a huge deal.

I know in Mississippi, many people in the reports said, well, it was only 2 percent of the things. Well, it might be 2 percent of the total of the whole Katrina problem, for instance, but it could be 100 percent of the losses in a six-, eight-, ten-mile area. So be careful about using these percentages.

But this is a very important component. It makes it more predictable. It would make the rates, in my opinion, lower for the insurance companies because they would not have to deal with the unpredictability of being forced to cover flood when they did not offer it. It would make the Flood Insurance Program more predictable, ratable. It would encourage participation in the Flood Program. And, of course, with the help of the State FAIR plans and wind pools, that would all work together.

Now, there are others—I will take quickly—there are other things that we can talk about, all-in plans. Those have some things that have to be dealt with in trying to bring the private sector into that and make it available that they would be able to offer that, and I think there are some problems with that.

But I see that I am out of time, and so I will respectfully stop. I have a lot of things I could say about and would be glad to take questions. Thank you so much.

Chairman JOHNSON. Thank you.

Ms. Brown, you have mentioned a number of challenges facing the Flood Insurance Program. Would you please give us your recommendations for the most important steps necessary to make the program financially sound and remove it from GAO's High-Risk List?

Ms. BROWN. The efforts that it would take to get NFIP off the High-Risk List would have to come from Congress. They are the structural issues that need to be addressed. And then, also, there are a number of management challenges that FEMA would also have to address to get off the list.

So in terms—I will start with FEMA. In terms of getting off the list, there are a number of criteria that we use to take a program or an agency off. We would look for commitment of management. We have started to see that commitment. We also would need to see identified action plans, so there would have to be an identification of root causes of the management challenges that they face. Then they would have to identify effective actionable actions that they would have to take. And part of that would have to do with addressing the many open recommendations that GAO has. I think—I did a quick tally this morning, and it is somewhere around 49 open recommendations that would need to be addressed.

Chairman JOHNSON. Ms. Brown and Mr. Plunkett Ms. Brown, some have proposed a delay or phasing approach for setting insurance rates for homeowners in new high-risk areas. This clearly reduces the impact on homeowners, but are there any downsides to such an approach? What might the impact be on the fund and the taxpayer? Are there any potential unintended consequences for homeowners' receptions of risk?

Ms. BROWN. I think the same challenges that having subsidized rates also apply to grandfathered rates for those that are remapped into higher-risk areas. It does not make very clear that people are living in harm's way, is the biggest challenge, and that is one of the reasons that we cite in terms of making sure that people—that rates are moved to a more full-risk rate basis. The same goes for property owners that are remapped into higher-risk areas.

We did work on specifically the impact of the grandfather rates on NFIP and we found that because FEMA was not tracking the number of properties that were actually grandfathered, they were not able to quantify the impact of those grandfathered rates on the program. So that is something that they are now beginning to track those rates, but it has to be factored into their calculation and their rate-setting process.

Mr. PLUNKETT. Senator, there are several downsides. One, unsafe building will continue because people will not understand the flood risk that they are dealing with, or they will not purchase insurance if they are not mandated to do so.

Second, the indiscriminate and disproportional subsidies, often to more affluent builders and homeowners, will continue. I would say those are the two top.

Chairman JOHNSON. Mr. Kolton, Mr. Berginnis Mr. Kolton, in your testimony, you mentioned that you would like FEMA's maps to be more graduated rather than the current system of showing properties as simply in or out of the floodplain in order to give people better understanding of the risks. Administrator Fugate also mentioned this issue in his testimony before the Committee. When do you think FEMA will be able to provide this level of detail in its maps? What resources do you think they need in order to achieve this goal?

Mr. KOLTON. Thank you, Mr. Chairman. This is important that we look at the varying degrees of risk much in the way the private insurance market would for differences between, you know, like 10-, a 100-, a 75-year, 500-year floodplain. We ought to see those on the map. There are different degrees of risk and people need to understand what those risks are. In addition, the rates ought to reflect those risks. It is too simplistic to have an "in or out" 100-year floodplain approach, a 1-in-100 chance of flooding.

In terms of resources, we believe that the mapping proposal, the technical mapping proposal is a good one and will provide much-needed assistance and bring expertise to assist FEMA as it moves forward with the process.

Mr. BERGINNIS. In terms of the graduated risk issue, I think it is important to understand, at least in utility, the Flood Insurance Rate Maps that FEMA produces are the Nation's flood maps, yet we have flood hazard areas, such as dam failure inundation maps, or levee failure overtopping maps, other flood risk frequencies, such as the 500-year flood. A lot of those are not shown on those particular maps, yet those represent, those areas represent an area of inherently higher flood risk and inherently catastrophic flood risk should those defenses fail.

And we also have, I think, today, there is at least a partial inventory of some of that mapping that is available. They just are not put on the Flood Insurance Rate Maps. Now, FEMA's new Risk Map Program, one of the things I think the new program is going to do is it provides what are called nonregulatory products, being the Flood Risk Map and Flood Risk Report, and at least the Flood Risk Map, in theory, should have the ability to show some of these other areas in terms of doing that.

From a resource standpoint, one of the things that we think FEMA should be tasked with doing is really looking at the long-term programmatic cost of what flood mapping should be. There was a shift in philosophy and products developed from map modernization to Risk Map, and in doing so, the Association of State Floodplain Managers thinks that the data being provided under Risk Map is good data, but it does change the cost calculus that would go into that.

So we think that there should be a long-term estimate of the mapping cost. But I will say that we are very, very concerned about the significant reduction in mapping budget that has occurred this year, right as we are experiencing one of the most devastating flood years in recent times.

Chairman JOHNSON. Ms. Brown, do you have any comment?

Ms. BROWN. No.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you. Mr. Chairman, I ask that my opening statement be made part of the record.

Mr. Plunkett, you have been here many times on this same issue. I remember in 2005, 2007, you worked on this. Something that has been a problem for me always has been why should the American taxpayers subsidize these policies, or risk, for people who, a lot of them have second, third homes, knowing that they are in a risk area. Why should the other taxpayers pay for that?

Mr. PLUNKETT. Senator, there is clearly an equity issue here.

Senator SHELBY. Mm-hmm.

Mr. PLUNKETT. Obviously, there are people in floodplains who are going to have difficult affording——

Senator SHELBY. We understand.

Mr. PLUNKETT. ——flood insurance, especially if it is priced the correct way, if it is actuarially priced. But to have others who can afford it subsidized actually drains resources that could be used to help the people who need it the most.

Senator SHELBY. In the Flood Insurance Program as we currently have, and we keep kicking the can down the road, it is basically, one, broken, and it is very flawed, is it not?

Mr. PLUNKETT. We think the program is extremely flawed in a number of ways. It is not only essentially bankrupt, but it subsidizes unsafe construction. That puts people in harm's way. And there is very poor administration by FEMA of the program.

Senator SHELBY. Ms. Brown, why do only 50 percent of the property owners who are required to have flood insurance actually—why do they not have a policy?

Ms. BROWN. This is an outstanding and ongoing issue. GAO last looked closely at this issue about 9 years ago and found that, one, determining compliance with the flood insurance requirement is difficult to calculate. If you talk to bank regulators, we found that the bank regulators will generally do some limited sampling, determine it is not a compliance issue. If you talk to FEMA and other stakeholders, they look at the number of policies in force in Special Flood Hazard Areas compared to the number of new and existing mortgages and find that compliance is a problem. So I think it really is an issue of enforcing the requirement that currently exists, which is important to do.

Senator SHELBY. All right. So, basically, that begs the question whether FEMA and the bank regulators are doing their job. If they were doing their job, they would not have a 50 percent insurance program.

Mr. PLUNKETT. Senator, part of the issue of doing their job is the mapping.

Senator SHELBY. I know.

Mr. PLUNKETT. If they were doing proper mapping, then people would know they were in harm's way.

Senator SHELBY. What happened to the mapping program that was going to go on just a few years ago and everybody was talking about? They were going to map to manage risk and tell people what floodplain they were in, the real risk that they assumed where they live.

Mr. PLUNKETT. It is a very good question. Administrator Fugate, when he testified before you earlier this month, said that in 2003, I believe, it was 70 percent of the maps were more than 10 years old, but he did not provide information, current information as to how many of the maps are too old right now.

Senator SHELBY. Is part of the problem, Mr. Plunkett, dealing with people who would buy insurance or could afford insurance, is part of it the lack of information that they are really in a floodplain area or marginal area or what? Is that part of the problem, and does that go to mapping itself?

Mr. PLUNKETT. Absolutely, Senator. It goes directly to mapping, and we saw the tragic consequences of that, especially during Hurricane Katrina.

Senator SHELBY. Mr. Rutenberg, in your testimony, you state that homeowners living in residual risk areas should not be required to purchase flood insurance. That is a disturbing statement to me. You state that requiring communities with a flood control structure to first purchase flood insurance raises, quote, "real and powerful equity and fairness issues." This year has proven that even those communities with a flood control structure are not immune from flooding. My question is, if communities with flood control structures are not required to have flood insurance, does this leave them vulnerable to losses caused by floods like we have seen this year?

Mr. RUTENBERG. Senator Shelby, you raise an interesting point, but my personal experience with the Flood Insurance Program and floodplains in Florida has been that the newer homes and newer developments are being done with increasingly more stringent stormwater management systems. In my locality, we have to have all of our stormwater structures be prepared for an 18-inch storm event, which is 18 inches more than the existing one. So I think that we have questions as to how to integrate into existing as well as the new developments.

Senator SHELBY. Mr. Kolton, do you agree with him on that equity issue? Are there any issues of fairness and equity in not requiring these communities to have flood insurance?

Mr. KOLTON. Senator Shelby, we think it is desperately critical that people have flood insurance——

Senator SHELBY. Absolutely.

Mr. KOLTON. ——that are at risk. If they do not have flood insurance and a catastrophic event happens, they are not going to be made whole by the existing relief programs of the Federal Government. They will not be insured. So that is fundamental.

Second, you can turn on your evening news and see levees being overtopped in North Dakota. We do not need to tell this Committee that just being behind a flood control structure does not mean you are protected. There are thousands of flood control structures across the country that are not providing adequate flood protection. People need flood insurance behind these structures.

Senator SHELBY. Quickly, Mr. Richardson, wind *versus* water debate, very, very important. We do not know—we have seen some studies that say if we include wind damage in all this, it will cost a heck of a lot of money. In your testimony, you wrote that the real issue with slab claims is that those contesting the loss allegation either did not have flood insurance or did not have adequate flood insurance. As a result, property owners sought higher payments from their wind insurance policies to cover the flood damage. If the real issue is inadequate flood insurance, would the standard loss allocation method that you propose actually change the outcome for most policyholders, and what would it do to the insurance fund, the actuarial soundness of a fund, if we included wind?

Mr. RICHARDSON. Well, we are talking about the whole ratings system, Senator.

Senator SHELBY. Yes.

Mr. RICHARDSON. What you are trying to do—I get back to what I stated in the beginning—is creating predictability. One of the things that has been mentioned here several times by panel members is that the rates become actuarially sound. I would be very careful with that if I were you, because if you think you have ever gotten 10,000 phone calls about a particular issue, you start charging actuarially sound rates right out of the chute, that would be problematic. I think it is a worthy goal. You need to get to that. But, frankly——

Senator SHELBY. Now, if you are not going to charge for the risk, who is going to be charged for the risk?

Mr. RICHARDSON. No, I think you should——

Senator SHELBY. You are not talking about charging the taxpayer——

Mr. RICHARDSON. No, sir, I am not. I think that is where you should go. But my point is, you have had a system for 40 years that was not actuarially sound. You can create actuarially sound rates for new construction, because then someone can make the choice. Do they want to pay it or not. But we have millions of homes right now that we have to figure out, what do we do? How much can they stand? Is it a 5-year phase-in? Ten-year phase-in? But the big issue is, if we make it actuarially sound, you will not need the NFIP.

Senator SHELBY. Absolutely.

Mr. RICHARDSON. You could basically phase this thing out by making——

Senator SHELBY. That would be my goal.

Mr. RICHARDSON. Exactly. Now, your question, well, that is not a bad goal, but you just need to be——

Senator SHELBY. I thought it would be a worthy goal, not a bad goal.

Mr. RICHARDSON. Well, it would be a worthy goal, absolutely. But on the indeterminate loss, one of the issues that we had not talked about is the value of the homes, because the flood insurance only provides certain limits, as you know. So the higher the values get, the more complicated the amount of insurance is, and whether it is flood, whether it is wind, and so forth.

One panelist made the statement that we should make people purchase flood insurance in those zones. I totally agree with that. Either you buy it or you get no Federal assistance. Until the Federal Government quits giving people money for being irresponsible, then you are going to have a very low penetration of people that are going to buy it because there is no penalty for them. If they have no penalty and a Katrina hits and they get paid anyway, whether they have the policy or not.

But in these systems, we have to have a melding of the Flood Insurance Program and the all other perils that are going to come by your carriers, and if you have a system that very specifically states who pays what—to give an example to you, let us say you had our Standard Loss Allocation System, and for a particular area, it said, OK, this was 60 percent wind and 40 percent flood. If somebody did not have a flood insurance policy, they have got a problem with 40 percent of their claim. The insurance company is going to hand them the 60 percent of the money that was their problem. If they chose not to buy flood insurance, then they have got a 40 percent problem, as it should be. People will start saying, "I have got to buy flood insurance or I am going to have a problem." That is how it takes care of itself. There are a lot of incentives in here to have a system that very predictably creates it.

The other problem you have got, Senator, in your State, you had issues where you had—you could easily have 200 or 300 homes and have 200 or 300 totally different outcomes on what the claim was. Now, I understand some houses are frame, some houses are brick and mortar and so forth. Some houses are flat on the ground, some houses are higher. All that should be taken into effect. But let us assume we had 100 houses. They were all flat on the ground. They were all frame. They were all 25 years old, *et cetera, et cetera*. Every one of those claims, theoretically, should be settled exactly the same.

Chairman JOHNSON. Senator Reed.

Senator SHELBY. Thank you.

Senator REED. Well, thank you very much, Mr. Chairman, and thank you, the witnesses here. Great testimony.

One of the issues we all seem to focus on is the flood mapping, which I would like to probe a bit further, and I want to thank Mr. Kolton for mentioning the Technical Mapping Advisory Council and the National Mapping Program. I think that was a—I helped contribute to that along with many of my colleagues here in terms of the 2008 legislation and I think it would be very useful if we could move that.

But Mr. Berginnis, as I understand it, there is a choice of doing a detailed study or the approximate study, and as GAO has pointed out, the detailed study, as the name implies, is much more accurate, much more effective, and uses more reliable data. So who, from your perspective, who determines the type of study which should be undertaken to update a map?

Mr. BERGINNIS. That study need is first determined at the, really at the State and local level. What happens in the mapping process is that FEMA first solicits from States and communities where those mapping needs are. For example, there could be an unincorporated little neighborhood area in a rural community that there is an acute need right there to have detailed mapping, but maybe on the rest of the water course, there is not. Then based on all of those mapping needs being evaluated at one time, you know, the reality is there is a mapping budget that has to be met, and I have not heard a situation yet where a mapping budget has been adequate enough to cover those.

Senator REED. And just——

Mr. BERGINNIS. Sure.

Senator REED. ——the mapping budget is the local budget——

Mr. BERGINNIS. It is——

Senator REED. ——or the FEMA budget or——

Mr. BERGINNIS. It would be the FEMA budget on a per study basis in doing it. And so from there, then priorities are made and that do take into account State and local priorities, but also FEMA, I know, has some formulas in terms of designating mapping budgets that includes risk, the overall community risk and watershed risk and doing those kinds of things.

Senator REED. But it seems to me that because, as I understand it, they are—using approximate data is a lot cheaper than using a detailed study and there are budget pressures so that we have built in a disincentive to do some of the most specific detailed more accurate mapping. Is that——

Mr. BERGINNIS. The—I am not sure it is as much of a disincentive as it is just a recognition of the realities of the mapping budgets. Again, the disparity between the need and the amount of money available is significant.

Senator REED. Right, but let me just pursue this one more, and that is, by and large, can you comment on—generally, FEMA is using, I would guess, approximations, if you look at their activities, rather than detailed mapping? Is that your impression, or is that——

Mr. BERGINNIS. I think they are using a combination of both.

Senator REED. OK.

Mr. BERGINNIS. The one thing I do want to mention about approximations——

Senator REED. Yes?

Mr. BERGINNIS. ——that are interesting, I remember when I first started as a State official working with the flood maps in the early 1990s, the approximate maps were literally dots on a map. I mean, they were—and when I heard stories about how they were created, it really was not terribly technically sound.

Today's approximate mapping, most of the mapping, if not all of it, actually has engineering models behind it now. So there are efficiencies even in the approximate mapping that make it better as a product than before.

Senator REED. I know Mr. Rutenberg wants to make a comment, but just a final point is that the new maps, are they—how effective are they incorporating all the different data sources that have come online—storm surge, coastal inundation, information from the Corps of Engineers, NOAA information? Is that being effectively factored into these maps or is that sort of still outside and not being used?

Mr. BERGINNIS. Well, the process is good where it allows consideration of all those things, but actually incorporating all of those data into the maps is something that is not being done nearly as much as it should, and again, I think it goes back to the budget and cost of doing it.

Senator REED. Yes. But from your perspective——

Mr. BERGINNIS. Sure.

Senator REED. ——incorporating that data would be helpful, useful, and provide more accurate——

Mr. BERGINNIS. Oh, absolutely. Absolutely.

Senator REED. And then in my final few moments, Mr. Rutenberg, you had a comment. I do not want to cut you off.

Mr. RUTENBERG. Thank you, Senator Reed. I know my place. I am glad to wait.

Senator REED. Please.

Mr. RUTENBERG. One of the things that strikes me is that there is a lot of locally generated information which is not being used in deriving the FEMA maps, and some of it is very good and some of it is not, but you could have criteria to examine it. I know that when I did a development, I had to do—my engineer's stormwater had to be checked by the city. It had to be checked by the county. We even hired an engineer. We paid the neighbor's engineer to review it. And this information is not included in the FEMA maps, as if those stormwater areas are not there. So some areas are good, some are not, but there is a potential savings for the Federal Government to get better maps quicker by utilizing local information that meets a certain standard. Thank you.

Senator REED. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thank you, Mr. Chairman, very much, and thanks to all of our witnesses.

My top goal in this work is to produce a full long-term reauthorization of the program. That is very basic, but I want to sort of step back to that basic issue. My observation experience, particularly coming from Louisiana, where we have and need a lot of this insurance, is that the stop-gap measures we have been passing, for instance, through last year, have been really detrimental to closings and to helping get the market going and get out of this recession, and that was extremely counterproductive last year, particularly when we had some gaps in the program, and I wonder if anyone like Mr. Rutenberg, who is certainly familiar with the real estate sector, could comment on that.

Mr. RUTENBERG. The gaps you are referring to are gaps in the program. I had a personal experience last year where we were building a home and we closed the construction on it in September and we were not supposed to have to do flood insurance and it was the changes. We then had to do flood insurance and then you have to pour the slab, do your survey, and then you have to go 30 days—60 days through a process which is including going back to the county, getting it done, send it in, and so it was, like, 60, 90 days late getting the first money out of the house.

There are a lot of builders who have had to shut down construction. There are a lot of homeowners who could not close on loans, homeowners who cannot convey title. The gaps are very counterproductive, and the Realtors have mentioned it, as well.

Senator VITTER. Thank you. Yes, sir?

Mr. RICHARDSON. Yes, Senator. I think you are right on point, and I would go back—I hate to sound like a broken record, but if you make the program 5 years, if you implement the science that we now have available to us that we did not have available to us in the 1960s when a lot of these maps and things were done, you are going to get more and more players as the rates become closer to being actuarially sound. You will have the private industry enter this market. Insurance companies will insure anything that is predictable and is close to or actuarially sound. They will do it.

Senator VITTER. OK.

Mr. RICHARDSON. And so that is what you need.

Senator VITTER. I do not want to cut you off, but I need to get to other questions——

Mr. RICHARDSON. That is what you need.

Senator VITTER. ——but I appreciate it. So let me just underscore the point. We are coming out of a serious recession. We need every bit of growth we can get. We need every closing in sight. And so for us to work against that with short-term stop-gap measures, including lapses in the program, is just crazy. So I hope, whatever the nature of the bill, and I certainly have thoughts about that, we get a full long-term reauthorization.

Second, I want to address this issue, I think sometimes there is this assumption that any expansion of limits or expansion of coverage under the program is directly counter to making the program fiscally sound, actuarially sound, and I do not think that needs to be the case. I think the devil is in the details. In particular, Ms. Brown, in your written testimony, you say that, quote, "Increasing participation in NFIP and thus the size of the risk pool would help ensure that losses from flood damage did not become the responsibility of the taxpayer." Can we consider new aspects of the program, including higher coverage limits to account for inflation—we have not changed that since 1994—in a way, in an actuarially sound way that actually builds on that soundness and does not diminish it?

Ms. BROWN. Yes. We have looked at the issue of coverage limits and we found that, on average, most policies are well under the limit, and that is driven by a variety of factors. There are many properties that are under the $250,000 limit, and for properties that are well over the $250,000 limit, million-dollar homes, for example, there is often available excess flood insurance coverage that the private sector is willing to provide. So the issue of whether changing the limit will destabilize the program, it is not a clear-cut answer for that particular question.

Senator VITTER. Mr. Rutenberg, do you have any thoughts about this?

Mr. RUTENBERG. No.

Senator VITTER. OK.

Mr. PLUNKETT. Senator, on that question, the Consumer Federation would agree that expanding coverage does not have to be at odds as long as it is actuarially—at odds with the financial stability of the program as long as the coverage is offered in an actuarially sound way. But you have got to eliminate some of the subsidies that occur, some of which are hidden, such as FEMA administratively grandfathering rates from old maps when new maps are developed.

Senator VITTER. OK. So I just want to underscore this point. In fact, I would go further. It can increase participation in the program, which would help make the program more actuarially and fiscally sound, to have more realistic coverage levels and lines.

Just a final quick point. I want to support my colleague, Senator Wicker's, proposal, and I think Mr. Richardson discussed this. I can tell you, in the Katrina experience, like he can, I cannot quantify it exactly, but I can tell you that the taxpayer was ripped off royally in many cases because of flood damage being pushed—excuse me, because of wind damage being pushed onto the flood side and to the taxpayer. That happened. It happened over and over and the taxpayer was left holding the bag. Mr. Richardson, do you have any follow-up on that?

Mr. RICHARDSON. Well, Senator, I think you are exactly right, and once again, we get back to the science. We have the tools to determine this right now. I see no reason why we would not. When we can catalog it and we know exactly, or as close as we could from scientific evidence, what is wind and what is water, why would you not do that and eliminate litigation? You eliminate—I know in your State and others, one of the big problems is the economy. If you have thousands of situations sitting there, waiting to be paid, and you cannot build a house, the gentleman here, the Home Builders do not build the homes, you do not get the taxes paid on the property, I mean, it compounds and creates a very unhealthy economic situation that could have been solved in 60 days, perhaps, instead of 6 months, a year and 6 months, so——

Senator VITTER. Thank you very much.

Chairman JOHNSON. Senator Tester.

Senator TESTER. Yes, thank you, Mr. Chairman. I want to thank the panel for being here today. I very much appreciate all of your testimony. I have got a lot of questions and little time.

I am going to start with you, Ms. Brown. You know very well, or maybe you do not, the Chairman talked about a high water year in South Dakota and the Missouri River drainage were creating to that. They are adding to it along the way. We have got historic flooding happening. Every one of you—almost every one of you talked about the actuarial soundness of the program and the program being upside down. Is there any estimate out there on how much more borrowing the Flood Insurance Program is going to have to borrow this year to take care of the historic flooding? Any estimates?

Ms. BROWN. No, none that we have seen. It really will depend on the claims, but it is a real risk. If this ends up being a very high flood year for NFIP, then it is very likely that they may have to borrow to actually pay their insurance——

Senator TESTER. OK. Well——

Ms. BROWN. ——their interest premium.

Senator TESTER. Got you. What would the impact on that additional borrowing have on this program?

Ms. BROWN. It would increase the debt that they owe to the Treasury.

Senator TESTER. OK.

Ms. BROWN. So it would further destabilize the program.

Senator TESTER. Actuarial soundness was something that, I mean, everybody wants to see. Everybody thinks it is very important, as do I. You talked about grandfathered rates. You talked about rates that mirrored the risk. If we are going to make the program actuarially sound so the taxpayer is not on the hook—and I will start with you, Ms. Brown, and anybody else can answer this, but make your answers as concise as possible—what kind of increase in rates are we looking at?

Ms. BROWN. They would be substantial.

Senator TESTER. Would they be 25 percent?

Ms. BROWN. Much higher than that.

Senator TESTER. OK. And what impact would that have on people's ability to insure? And I will kick it over to Mr. Plunkett. If rates went up by 25 percent plus, if they went up by 50 percent, possibly, what impact is that—I mean, you increase my insurance rates on my house by 50 percent——

Ms. BROWN. Hundreds.

Senator TESTER. ——I may have nothing.

Mr. PLUNKETT. The next step, Senator, would be to use the savings and probably more to create a means-tested program to help people who cannot afford the new higher rates.

Senator TESTER. The ultimate goal here, though, is to get everybody involved in the program that we can get involved in the program, right? I mean, the ultimate goal is everybody, rich, poor, medium, everybody involved. We are running, what, a $16 billion deficit in the program right now, is that correct?

Mr. PLUNKETT. Something like that.

Ms. BROWN. It is almost 18.

Senator TESTER. Almost $18 billion. Has anybody done the analysis on what the subsidies would be per year?

Mr. PLUNKETT. Those are—we do not have a number, but we think it is a better way to run the program. It diminishes a lot of the distortions and the unintended consequences and the counterproductive building that we are talking about, and it is absolutely essential. I mean, you have to—if you are going to require flood insurance, you have to——

Senator TESTER. No disagreement.

Mr. PLUNKETT. ——help people that cannot afford it do it.

Senator TESTER. But I think there is also agreement we want to take the taxpayers off the hook, and I am not sure we are doing that. Do you see what I am saying?

Ms. BROWN. In terms of a dollar amount on the current subsidy——

Senator TESTER. Yes.

Ms. BROWN. ——for the pre-FIRM, it is, by our calculation, we are talking maybe $1.6 to $2.1 billion a year.

Senator TESTER. OK. Go ahead.

Mr. BERGINNIS. Senator, if I could add, and this is why the actuarial soundness issue cannot be dealt with apart from the other aspects in terms of having a robust mitigation program, so again, folks who may be paying those rates can at least have an alternative to actually do something to reduce the rates, and then, second, why a more recent idea, this idea of if there is going to be a subsidy, have it outside the program. Have it as a means-tested voucher.

Senator TESTER. I have got you. One of the things about mitigation, though, is I look at the pictures going up and down the Missouri right now, is that a lot of those levees that were meant to keep water away from people are now keeping water on people, and so mitigation is important, and I agree it is going to live in the middle of a forest, but on the other side of the coin, sometimes it works exactly the opposite when it comes to water.

Mr. BERGINNIS. And that is actually a great observation and why mitigation has a lot of forms. There is structural, such as levees. But the nonstructural mitigation, such as individual house elevations, relocating areas out—just relocating folks outside of the floodplain in those——

Senator TESTER. I appreciate that. Yes, Mr. Rutenberg?

Mr. RUTENBERG. To that point, Senator, I think that you can have some incentives within the program. For example, if you were elevated above a certain point related to the floodplain——

Senator TESTER. Right.

Mr. RUTENBERG. ——then that would give you a deductible and that would become a good investment for someone who was building. There are some options there that could be free-marketing good.

Senator TESTER. Very good, and I would love to hear those, and we will have a bunch of other questions directed, so I appreciate it.

I have just one quick thing and then I am going to let you guys go. Senator Wicker does have a proposal on wind. You addressed it, Mr. Richardson. We are talking about actuarial soundness. Can you get insurance for wind at this point in time in the private sector?

Mr. RICHARDSON. Yes.

Senator TESTER. OK.

Mr. RICHARDSON. It is readily available.

Senator TESTER. Has there been any estimate, if wind is added to the flood program, what kind of increase, if we are going to make it actuarially sound, what kind of increase that is going to have on premiums?

Mr. RICHARDSON. I would say to you simply, why would you add something to a Federal program that is readily available in the private market? Do not go there.

Senator TESTER. OK, so——

Mr. RICHARDSON. Do not go there. It would blow the Federal program——

Senator TESTER. I do not want to do that. Maybe I will back up. I thought that was the proposal, is——

Mr. RICHARDSON. No, no, no——

Senator WICKER. It is not in the proposal.

Senator TESTER. OK. Super. I was misinformed and I apologize, and you are absolutely right. You do not add it if it is available in the private sector.

Once again, thank you all very much. I appreciate your testimony and your perspective.

Chairman JOHNSON. Senator Wicker.

Senator WICKER. Thank you, Mr. Chairman, for a balanced panel. I think so many issues have been raised that it demonstrates why this program has not been reauthorized up until this point, because it is so complicated.

And, Senator Tester, thank you for raising that question. My proposal, which we are calling the COASTAL Act, would not add wind to the Flood Control Program. It is a scientific way of allocating the loss between wind and flood when both perils are involved and when there is nothing but a slab left.

And in that regard, I would point out, Ms. Brown is here on behalf of GAO. In 2007, GAO said, for a given property, NFIP does not know how each peril contributed to the total loss. GAO does not know and NFIP does not know how much was contributed by wind and how much was contributed by water. The GAO report goes on to say, or how adjustors working for Write Your Own insurers made such determinations. NFIP does not know how they made the determination between wind and water.

Further, the report says, FEMA cannot be certain whether NFIP has paid only for damage caused by flooding when insurers with a financial interest in apportioning damages between wind and flooding are responsible for making such apportionments, a conflict of interest that is underscored by the testimony today from the Consumer Federation of America. In the full testimony submitted for the record, Mr. Plunkett says these Write Your Own insurers also have a serious conflict of interest when they settle hurricane claims for the program, since they make more money if they determine that losses were caused by flood damage rather than by wind damage.

I think Senator Vitter is right. It may very well be, based upon the testimony of these two witnesses, who I did not request but I think have made valuable contributions today, based upon their testimony, it may very well be that the Flood Insurance Program and the taxpayers have paid more than their fair share because you have got private insurance adjustors who have an inherent conflict of interest, or at least the appearance of a conflict of interest, in allocating more of the loss to the taxpayer and Uncle Sugar rather than to their own insurance companies, and it would seem to me, Mr. Richardson, that your proposal of scientific allocation deals with this. Am I correct in that?

Mr. RICHARDSON. Yes, sir, it is, and you are also correct in the Write Your Own Program does have a frailty of when you have an insurance company basically determine what they pay and what the National Flood Insurance Company would pay, with a single adjustor, is a potential moral hazard. There is no question. They get paid—I have forgotten what the—to manage those policies, they get paid, what, 30 percent? Ms. Brown might know. I think it is close to 30 percent. That is a huge number. If you look at TPA, what we call third party administrative things in the insurance industry, that is a number that is off the charts, you know, 30 percent to do that. That is way too high, but anyway, I will leave that.

But, I mean, it is efficient in many ways to have a single adjustor, but to have the single adjustor working for an individual company against the Federal Government where the Federal Government is the big honey pot, as you say, is crazy. And when you have the science to create a formula that would eliminate that, I cannot see why you would not do it and I applaud you for——

Senator WICKER. Let me ask you this, Mr. Richardson. We are not asking the Federal Government to come up with a new regime of data collection, are we, in your proposal?

Mr. RICHARDSON. No, sir. I would——

Senator WICKER. Tell us about the data that you would use, because I do not think we have spread that——

Mr. RICHARDSON. Well, NOAA and a lot of the things that are out there, this information is available. Now, we might want to make it more robust. We might want to have more collection centers. But a lot of this is already being done, and if this information is basically brought together and put into an algorithm that you could use actuarially, it is there. And not only that, but you could use the information for other people. You could rent the information to all sorts of people. We have studied that, as well, and I think you could dramatically reduce the cost of it in that way.

Senator WICKER. Let me——

Mr. PLUNKETT. Senator, could I pitch in here on this?

Senator WICKER. Yes, sir.

Mr. PLUNKETT. Thank you for mentioning our concern with the conflict of interest with the Write Your Own Program. We think your bill is laudable in its goal. We do worry, however, that even though some of this information is being collected now, charging FEMA, which has had trouble managing simpler aspects of the program, with creating this formula and getting all this information together and doing it right and doing it fair is too much for them to handle.

In the testimony—I will not give you the details because you only have a little time, but we suggest an alternative approach involving the law of averages, which is the way that auto claims are used when you have different claims between auto insurers. We would love to talk to you about that.

Senator WICKER. Well——

Mr. RICHARDSON. Senator, this does not make FEMA do it. It gives FEMA the ability to engage whomever they choose to do it. They can go to the private industry—I think I am correct in saying that—and have them create this formula. FEMA does not have to do it.

Senator WICKER. OK. I am——

Mr. PLUNKETT. They do have to manage it, though, and we are worried about their ability to do that.

Senator WICKER. I am a little over on my time, but I do appreciate Mr. Plunkett making that suggestion. I think you would concede that the current program does not work when it comes to the wind *versus* water claims in a slab situation, and you point out——

Mr. PLUNKETT. Most certainly, we would——

Senator WICKER. ——you point out that many Gulf Coast consumers are still in court dealing with claims they believe should have been paid under their wind coverage, and here we are in 2011 on a 2005 event, and your testimony is consumers still are in court on this determination, which whether under your proposal or under Mr. Richardson's proposal could be done much simpler and keep us out of court and away from huge legal fees.

Thank you all for your testimony, and thank you, Mr. Chairman.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chairman, and thank you to all for discussing these issues.

I am trying to get my hands around just how big a hole the program is in currently, and if I catch these various statistics correctly, and I am going to say them out loud so somebody can correct me here, but the policies being sold are about $3.5 billion per year, that the debt is about $18 billion currently, that if they are borrowing from Treasury at a 3-percent rate, that puts you at about half-a-billion per year. So just to pay the interest would be about a seventh of the current price of the policies, that is, if we are just paying the interest on that debt, and if we are paying off that debt and amortizing it over a certain number of years, depending on the number of years, policies would have to go up substantially. Is there any—I am assuming the answer is no, but is there any—first of all, are these numbers in the ballpark, and is there any sort of mechanism in the law in which rates are adjusted in order to cover the interest on the debt and to pay off the capital over a particular number of years, and if so, how many years and so forth? Who would like to help us understand the dynamics of this hole?

Ms. BROWN. Well, I would say your numbers are in the right ballpark, and no, there is no current mechanism in the law to allow FEMA to increase rates to start paying down the debt.

Senator MERKLEY. Why not?

Ms. BROWN. It just does not exist.

Senator MERKLEY. So FEMA has paid off some of the loans it has borrowed, I believe I understand.

Ms. BROWN. Yes.

Senator MERKLEY. So what determined how much they could pay off how fast?

Ms. BROWN. It is—basically, it has been driven by the claims rates. It is——

Senator MERKLEY. So if the claims were below the premiums and there is a surplus, you pay off some of the debt. Otherwise, you just live with an increasing balance. So what would you propose?

Ms. BROWN. Well, there are a couple of options we have looked at. I would like to note that FEMA can increase rates up to 10 percent annually by zone, so there is a possibility to adjust rates through that. But we have——

Senator MERKLEY. On an enduring basis?

Ms. BROWN. Umm——

Senator MERKLEY. Ten percent each year, it could go up?

Ms. BROWN. Yes. Yes.

Senator MERKLEY. OK.

Ms. BROWN. That is the cap for an increase in any given year.

Senator MERKLEY. All right.

Ms. BROWN. We have looked at various scenarios in terms of what it would take to pay down the current outstanding debt, and one option would be, for example, to have an additional fee to pay it down, but it would be in addition to a movement toward more full-risk rates and there are questions of equity and fairness to have future or current policyholders to repay the debt that was created for previous policyholders. So there are a number of ways to do it. I know the last legislation the Senate approved actually would forgive the debt. Dealing with the $18 billion outstanding debt is vital to increasing the ongoing stability of the program. But in years of any type of above-average flooding, FEMA risks having to borrow to make interest payments. So the debt would continue to balloon unless it is dealt with.

Senator MERKLEY. Yes, Mr. Richardson?

Mr. RICHARDSON. Senator, I would submit to you, and I have seen some studies, and perhaps—I think it might have been done by the Heartland Institute, who is here today—penetration of policy ownership is the way to solve this financially. If you had a much higher—you know, we have got some good regulations in the laws. If you make more people that are in flood zones, designated flood zones, have the flood insurance or they are ineligible for any kind of Federal help, you are going to raise the penetration, you are going to have more money coming in, and I think—I have seen that study, it shows, and Ms. Brown could relate to this, but you could very quickly take your—let us just say 10 percent of the people have flood insurance now. You raise that to 20, 30, 40, it will show you very quickly that you have enough money to make the Flood Insurance Program solvent just like it is.

Senator MERKLEY. And you are talking about only 10 percent inside a 100-year flood zone?

Mr. RICHARDSON. Some places, it is true. I mean, I would rather refer to Ms. Brown because I do not have those figures readily available, but, I mean, the only people you have mandating flood insurance is people who have mortgages that are federally backed and they have to have it. Other than that, I do not think—Ms. Brown might be able to say—I do not think there is any other mandate on the flood insurance. But——

Senator MERKLEY. Well, and indeed, no, I think you are absolutely right, and previously, someone had referred to the Federal mandate, but indeed, we have had a lot of discussion about mandates up here and it is quite different for it to be tied into a mortgage. But separate from a mortgage, you are proposing to say, yes, you must spend your money on this form of insurance?

Mr. RICHARDSON. If you want to be available for Federal assistance in the event of——

Senator MERKLEY. OK. I see.

Mr. RICHARDSON. ——not going to make you buy it——

Senator MERKLEY. I see.

Mr. RICHARDSON. ——but if you do not buy it and your house goes bye-bye, do not expect the Federal Government to come write you a check for your house.

Mr. BERGINNIS. Senator, if I could just also add this, this ties into the actuarial and really what is actuarial rating under this program. The debt that accrued was from catastrophic events and even though the subsidized policies are about a quarter of the policies in the NFIP, one could probably say that 100 percent are subsidized to the extent that you do not have any factor for catastrophic events built in there. Senator Shelby has—this is a point that he has raised repeatedly. But this is also one of the areas that perhaps is more promising for private sector involvement in terms of the use of reinsurance and those types of things.

Senator MERKLEY. My time is up and I thank you very much.

Ms. BROWN. I would like to note one thing. In terms of doing an analysis in terms of what it would take to pay down the debt, you also have to factor in that current interest rates are very low. If interest rates change, if there is another event, there are a number of moving parts that will impact the ability of the program to be able to pay off the debt.

Senator MERKLEY. Absolutely. Thank you.

Chairman JOHNSON. I would like to thank our witnesses for being here today.

Senator WICKER. Mr. Chairman?

Chairman JOHNSON. Yes.

Senator WICKER. I wonder if I could take a moment or two on a second round. It will not be long——

Chairman JOHNSON. Yes, you may.

Senator WICKER. I appreciate that. Let me ask—I want Mr. Rutenberg and Mr. Kolton to address this issue, and I will start with Mr. Kolton. If there is a levee, surely the property owner should get some reduced premium because that levee is there. You are not advocating, are you, flood insurance at the same premium for that type of property owner, are you?

Mr. KOLTON. No, Senator. We believe that what ought to be accounted for is the level of flood protection that exists and we ought to be looking at what level of protection exists from a particular levee. But it would be a mistake not to have any flood insurance behind a levee that is not accredited.

Senator WICKER. Well, OK. Well, the fact is, and I think, Mr. Rutenberg, you would agree with this, that most levees work, that most levees provide the protection that is necessary, and it is really not fair to make property owners act as though they had no protection whatever in their premiums, do you not agree, Mr. Rutenberg?

Mr. RUTENBERG. Senator, I agree, but I think it is a broader question than just the levees, if I might. This also goes back to my earlier point, that we have some communities and counties require much more in-depth stormwater management than others, and if you are going to take it to a different level, then you should really take it to a different level and have the rates be commensurate with the risk.

Senator WICKER. And just one final question, and that is to you, Ms. Brown. I do not understand why the banks do not do a better job of enforcing the requirement for flood insurance. If flood insurance is required at a closing, it would seem to me that NFIP and the banks have a responsibility to be just as aggressive as the banks are with any other kind of insurance. I have gotten calls from my mortgage company about my insurance. Even when there was a mistake, I did have insurance, but the company changed or whatever, they called me quickly. And I can assure you, they make sure that my hazard insurance premiums are up to date or they will impose another insurance requirement on me quickly.

Ms. BROWN. Mm-hmm.

Senator WICKER. That is not the way the Flood Insurance Program works, and I am mystified as to why banks and NFIP do not work together to enforce this requirement as aggressively as banks enforce the other types of insurance.

Ms. BROWN. No, it is, you know, very unusual, and part of it goes to this issue of it is not clear if the banks focus at the closing to ensure that there is flood insurance at closing, but the flood insurance is not maintained over the life of the mortgage. And part of the problem is the bank regulators, as I mentioned, they do a risk-based approach to examinations, so they have a number of consumer protection laws that they test for compliance with. So they are doing limited testing. They are not finding problems in their limited testing, so they are concluding that compliance is not an issue. But you talk to FEMA, and as I mentioned, they are looking at the number of properties in the Special Flood Hazard Areas and they are looking at new mortgages and they are determining that there is a gap in terms of the compliance. So it is an ongoing issue and it is one that definitely warrants attention.

Senator WICKER. It needs to be addressed in any reauthorization. Thank you, and Mr. Chairman, thank you for indulging me.

Chairman JOHNSON. Senator Shelby for a last observation.

Senator SHELBY. I was intrigued by the exchange a minute ago dealing with someone who would build a home or an office or whatever behind a levee and so forth, because it looks to me like that would tell me that, boy, I am in a floodplain. It is just a question of risk, and I understand that. To not have insurance would be nonsense. It would remind me if I had a home here in Washington or in my home town of Tuscaloosa, Alabama, and if I were ten houses from a fire station and a fireplug, water out there in front of my house, and I said, well, I do not need fire protection because

I have got the fire department, you know, I am fine. That is nonsense to me. If I were in a floodplain, at or near or building behind a levee, that would send a signal to me, whoa, we are in a floodplain. Mr. Kolton, what do you——

Mr. KOLTON. Senator, you are absolutely right. The National Committee on Levee Safety, which Congress authorized to look at this issue in the 2007 Water Resources Development Act, recommended that there be mandatory flood insurance behind levees, and——

Senator SHELBY. Because that would be a false security. You would think, looking at what has happened lately, the breaching—well, as we are talking, up in the Dakotas, for example. It could have happened in my State or in Mississippi or anywhere, breach those levees. And sooner or later, they could be breached. It might be 50 years. It might be 10 years. It might be 100 years. But the chances are in the floodplain.

Mr. PLUNKETT. Senator, we would also agree, and we would agree with Senator Wicker that, I mean, there should be coverage, but it could be lower if——

Senator SHELBY. Oh, I understand——

Mr. PLUNKETT. ——if the levees are in good shape. We would warn against an approach in the House NFIP bill which would say that if a levee has been decertified by FEMA as being in good shape, that rates could be lowered upon promises, essentially promises by communities that they are going to fix it. In other words, they are not done yet. They are thinking about it or they have started it, but it is not back up to snuff.

Senator SHELBY. Sure.

Mr. RICHARDSON. Senator——

Mr. BERGINNIS. Senator——

Mr. RICHARDSON. Senator, I would just say, do not rate anything based on promises. I mean, that goes against everything that has been said at this table here. In the insurance formula, when it is there, when you can prove it, that is when it gets rated and that is when you pay for it. Do not give somebody——

Senator SHELBY. I have been around politics for 40 years. You are absolutely right. Watch the promises.

Mr. BERGINNIS. And if I could just add one more thing on the rating of those properties behind levees, currently, if you had a levee that is certified to provide a level protection, so it is certified it is in good shape, if you made the flood insurance mandatory, you are paying those low-risk rates. That is in the current rating structure as it exists.

Senator SHELBY. Thank you.

Chairman JOHNSON. I would like to thank our witnesses for being here today to contribute to our NFIP reauthorization discussion. The NFIP has an important mission to aid in disaster mitigation and recovery, and the views that we have heard today will assist us as we chart a sustainable future for the program. This hearing is adjourned.

[Whereupon, at 11:43 a.m., the hearing was adjourned.]

[Prepared statements and additional material supplied for the record follow:]

## PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you, Mr. Chairman.

This year has been marked by extreme weather and natural disasters across the country. My own State was devastated by massive and deadly tornadoes in April.

According to NOAA, the United States has suffered eight natural disasters each costing in excess of $1 billion. The total damage is $32 billion and rising.

While these natural disasters include droughts, fires, and tornadoes, the historic flooding of the Mississippi and Missouri rivers has dominated the headlines lately. Unfortunately, the flooding may not end for months because rainstorms continue in the Midwest and last winter's snowfall is still melting.

To make matters worse, many communities that thought they were protected by levees have been flooded due to intentional breaches by the Army Corps of Engineers.

We may see even more extreme weather later this year as the National Weather Service predicts that 2011 will be a "busier-than-usual" hurricane season.

The severity of this year's weather highlights the need for the National Flood Insurance Program to be reauthorized and placed on a sustainable path.

For nearly 6 years, Congress has been unable to pass a long-term reauthorization of the flood program.

The short-term extensions have kept the program alive, but have prevented the implementation of important reforms.

This has made it difficult for communities in high-risk flood zones to plan for the future.

Accordingly, it is my hope that this year we can pass a long-term extension of the flood program that includes the reforms needed to make the program "actuarially sound."

I look forward to hearing from today's witnesses and hope that they can provide further insights on how the flood program should be modernized.

I am especially interested in hearing what can be done to increase participation in the program.

We know that most people that need flood insurance do not have it. We must explore ways to change that.

We can have the best flood insurance program in the world, but it will do little good if people do not participate. Although the flood program expires in a few months, I am confident that the Committee can successfully work together to, once again, pass bipartisan legislation.

Thank you Mr. Chairman.

---

## PREPARED STATEMENT OF SENATOR MIKE JOHANNS

Thank you for being here today and your willingness to testify about an issue that is currently so critical to Nebraskans. According to the National Geospatial-Intelligence Agency, about 110,000 acres of land have been affected by the flood waters in Nebraska. The water has hit people's homes and livelihoods; in some areas, wiping them out. Yesterday, I met with FEMA Administrator Craig Fugate and the U.S. Army Corps of Engineers Brigadier General John McMahon to talk about what they're doing to try and relieve some of the suffering Nebraskans are facing. I also shared with them some of the concerns surrounding their water release and flood insurance decisions. My constituents and I are concerned about some of the Corps decisions on water releases, and FEMA's decision to designate a single start date for the entire Missouri River Basin. FEMA has announced that June 1, the date at which floodwaters were first released from the Garrison Dam in North Dakota, is the official starting point of the Missouri River Basin flooding.

However, there were multiple releases from multiple dams, some much closer to Nebraska. It's not clear why releases from the Garrison Dam, in North Dakota, are the start of the floods in Nebraska. I know that these agencies have their hands full right now getting help to people. But they're also going to have to answer some pretty frank questions. I look forward to having our witnesses help us understand the risk that people both inside and outside of 100-year floodplains contend with, and how that impacts the overall insurance system. With that, Mr. Chairman, I conclude my statement, and thank the witnesses again for being here today.

**PREPARED STATEMENT OF ORICE WILLIAMS BROWN**

DIRECTOR, OFFICE OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT,
GOVERNMENT ACCOUNTABILITY OFFICE

JUNE 23, 2011

United States Government Accountability Office

GAO

Testimony

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

For Release on Delivery
Expected at 10:00 a.m. EDT
June 23, 2011

# FLOOD INSURANCE

## Public Policy Goals Provide a Framework for Reform

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

GAO
Accountability * Integrity * Reliability

GAO-11-670T

June 23, 2011

# FLOOD INSURANCE

## Public Policy Goals Provide a Framework for Reform

GAO
Accountability • Integrity • Reliability
# Highlights

Highlights of GAO-11-670T, a testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

### Why GAO Did This Study

The National Flood Insurance Program (NFIP) has been on GAO's high-risk list since 2006, when the program had to borrow from the U.S. Treasury to cover losses from the 2005 hurricanes. The outstanding debt is $17.8 billion as of June 2011. This sizeable debt, plus operational and management challenges that GAO has identified at the Federal Emergency Management Agency (FEMA), which administers NFIP, have combined to keep the program on the high-risk list. NFIP's need to borrow to cover claims in years of catastrophic flooding has raised concerns about the program's long-term financial solvency. This testimony (1) discusses ways to place NFIP on a sounder financial footing in light of public policy goals for federal involvement in natural catastrophe insurance and (2) highlights operational and management challenges at FEMA that affect the program.

In preparing this statement, GAO relied on its past work on NFIP, including a June 2011 report on FEMA's management of NFIP, which focused on its planning, policies, processes, and systems. The management review included areas such as strategic and human capital planning, acquisition management, and intra-agency collaboration.

GAO has made numerous recommendations aimed at improving financial controls, oversight of private insurers and contractors, and FEMA's management of NFIP. DHS generally agreed with our recommendations.

View GAO-11-670T or key components. For more information, contact Orice Williams Brown at (202) 512-9678 or williamso@gao.gov.

### What GAO Found

Congressional action is needed to increase the financial stability of NFIP and limit taxpayer exposure. GAO previously identified four public policy goals that can provide a framework for crafting or evaluating proposals to reform NFIP. These goals are:

- charging premium rates that fully reflect risks,
- limiting costs to taxpayers before and after a disaster,
- encouraging broad participation in the program, and
- encouraging private markets to provide flood insurance.

Successfully reforming NFIP would require trade-offs among these often competing goals. For example, nearly one in four policyholders does not pay full-risk rates, and many pay a lower subsidized or "grandfathered" rate. Reducing or eliminating less than full-risk rates would decrease costs to taxpayers but substantially increase costs for many policyholders, some of whom might leave the program, potentially increasing postdisaster federal assistance. However, these trade-offs could be mitigated by providing assistance only to those who need it, limiting postdisaster assistance for flooding, and phasing in premium rates that fully reflect risks. Increasing mitigation efforts to reduce the probability and severity of flood damage would also reduce flood claims in the long term but would have significant up-front costs that might require federal assistance. One way to address this trade-off would be to better ensure that current mitigation programs are effective and efficient. Encouraging broad participation in the program could be achieved by expanding mandatory purchase requirements or increasing targeted outreach to help diversify the risk pool. Such efforts could help keep rates relatively low and reduce NFIP's exposure but would have to be effectively managed to help ensure that outreach efforts are broadly based. Encouraging private markets is the most difficult challenge because virtually no private market for flood insurance exists for most residential and commercial properties. FEMA's ongoing efforts to explore alternative structures may provide ideas that could be evaluated and considered.

Several operational and management issues also limit FEMA's progress in addressing NFIP's challenges, and continued action by FEMA will be needed to help ensure the stability of the program. For example, in numerous past reports, GAO identified weaknesses in areas that include financial controls and oversight of private insurers and contractors, and made many recommendations to address them. While FEMA has made progress in addressing some areas, GAO's June 2011 report identified a number of management challenges facing the program, including strategic and human capital planning, records management, collaboration among offices, and financial and acquisition management. In this report, we also made a number of recommendations to address these challenges. FEMA agreed with the recommendations and discussed the steps being taken to address some of them.

Chairman Johnson, Ranking Member Shelby, and Members of the Committee:

I appreciate the opportunity to participate in today's hearing on National Flood Insurance Program (NFIP) reform. As you know, NFIP is the key component of the federal government's efforts to minimize the damage from and financial impact of floods and is the only source of insurance against flood damage for most residents in vulnerable areas. NFIP has been on GAO's high-risk list since March 2006 after incurring billions of dollars in catastrophic losses from the 2005 hurricanes. Further contributing to NFIP's high-risk classification are operational and management challenges that we have identified within the Federal Emergency Management Agency (FEMA) that affect the program. As of June 2011, NFIP still owed almost $17.8 billion to the Department of the Treasury (Treasury) for loans used to cover losses from the 2005 hurricanes. The magnitude of this debt highlights the many financial challenges the program faces, including structural weaknesses in the way it is funded, and the managerial challenges that have affected FEMA's administration of NFIP. Any efforts to help stabilize NFIP will require addressing both the program's financial challenges and its operational and management issues.

My statement today discusses four public policy goals that GAO has developed for evaluating federal involvement in the provision of natural catastrophe insurance and identifies key program areas needing reform, potential ways to better fulfill these goals, and the trade-offs that would be required. This statement also sets out the operational and managerial challenges facing NFIP that we have identified in our past reports, including a report that was issued earlier this month.[1] The work that this report was based on was performed from March 2006 through June 2011. We performed our work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]See GAO, *FEMA: Action Needed to Improve Administration of the National Flood Insurance Program*, GAO-11-297 (Washington, D.C.: June 9, 2011).

## Background

The National Flood Insurance Act of 1968 established NFIP as an alternative to providing direct assistance after floods.[2] NFIP, which provides government-guaranteed flood insurance to homeowners and businesses, was intended to reduce the federal government's escalating costs for repairing flood damage after disasters. FEMA, which is within the Department of Homeland Security (DHS), is responsible for the oversight and management of NFIP. Since NFIP's inception, Congress has enacted several pieces of legislation to strengthen the program. The Flood Disaster Protection Act of 1973 made flood insurance mandatory for owners of properties in vulnerable areas who had mortgages from federally regulated lenders and provided additional incentives for communities to join the program.[3] The National Flood Insurance Reform Act of 1994 strengthened the mandatory purchase requirements for owners of properties located in special flood hazard areas (SFHA) with mortgages from federally regulated lenders.[4] Finally, the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 authorized grant programs to mitigate properties that experienced repetitive flooding losses. Owners of these repetitive loss properties who do not mitigate may face higher premiums.[5]

To participate in NFIP, communities agree to enforce regulations for land use and new construction in high-risk flood zones and to adopt and enforce state and community floodplain management regulations to reduce future flood damage. Currently, more than 20,000 communities participate in NFIP. NFIP has mapped flood risks across the country, assigning flood zone designations based on risk levels, and these designations are a factor in determining premium rates. NFIP offers two types of flood insurance premiums: subsidized and full risk. The National Flood Insurance Act of 1968 authorizes NFIP to offer subsidized premiums to owners of certain properties. These subsidized premium rates, which represent about 40 percent to 45 percent of the cost of covering the full risk of flood damage to the properties, apply to about 22 percent of all NFIP policies. To help reduce or eliminate the long-term risk of flood damage to buildings and other structures insured by NFIP, FEMA has used a variety of mitigation efforts, such as elevation, relocation, and demolition. Despite these efforts, the inventories of repetitive loss

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

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

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

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

properties—generally, as defined by FEMA, those that have had two or more flood insurance claims payments of $1,000 or more over 10 years—and policies with subsidized premium rates have continued to grow.[6] In response to the magnitude and severity of the losses from the 2005 hurricanes, Congress increased NFIP's borrowing authority from Treasury to about $20.8 billion.

## Efforts to Reform NFIP's Financial Structure Will Require Balancing Public Policy Goals

We have previously identified four public policy goals for evaluating the federal role in providing natural catastrophe insurance:

- charging premium rates that fully reflect actual risks,
- limiting costs to taxpayers before and after a disaster,
- encouraging broad participation in natural catastrophe insurance programs, and
- encouraging private markets to provide natural catastrophe insurance.[7]

Taking action to achieve these goals would benefit both NFIP and the taxpayers who fund the program but would require trade-offs. I will discuss the key areas that need to be addressed, actions that can be taken to help achieve these goals, and the trade-offs that would be required.

[6] The Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 amended the existing definition of the term "repetitive loss structure" to the current one: a structure covered by a contract for flood insurance that has incurred flood-related damage on two occasions, in which the cost of repair, on the average, equaled or exceeded 25 percent of the value of the structure at the time of each such flood event; and at the time of the second incidence of flood-related damage, the contract for flood insurance contains increased cost of compliance coverage, which can help property owners pay for the cost of mitigation measures for flood-damaged properties. 42 U.S.C. § 4121(a).

[7] See GAO, *Natural Disasters: Public Policy Options for Changing the Federal Role in Natural Catastrophe Insurance*, GAO-08-7 (Washington, D.C.: Nov. 26, 2007).

## Charging Full-Risk Rates Would Improve NFIP's Financial Soundness but Could Reduce Program Participation

As I have noted, NFIP currently does not charge all program participants rates that reflect the full risk of flooding to their properties.[8] First, the act requires FEMA to charge many policyholders less than full-risk rates to encourage program participation. While the percentage of subsidized properties was expected to decline as new construction replaced subsidized properties, today nearly one out of four NFIP policies is based on a subsidized rate. Second, FEMA may "grandfather" properties that are already in the program when new flood maps place them in higher-risk zones, allowing some property owners to pay premium rates that apply to the previous lower-risk zone. FEMA officials told us they made the decision to allow grandfathering because of external pressure to reduce the effects of rate increases, and considerations of equity, ease of administration, and the goals of promoting floodplain management. Similarly, FEMA recently introduced a new rating option called the Preferred Risk Policy Eligibility Extension that in effect equals a temporary grandfathering of premium rates.[9] While these policies typically would have to be converted to more expensive policies when they were renewed after a new flood map came into effect, FEMA has extended eligibility for these lower rates. Finally, we have also raised questions about whether NFIP's full-risk rates reflect actual flood risks. Because many premium rates charged by NFIP do not reflect the full risk of loss, the program is less likely to be able to pay claims in years with

[8]Premium rates that reflect the "full risk" of flooding can mean different things, and there is no standard definition for this term. An actuarial approach to ratemaking would produce rates that cover a best estimate of average expected losses, plus an additional margin for risk. The question then becomes how big the risk margin should be, a decision that will be influenced in turn by the characteristics of the risk (including the magnitude of potential catastrophic losses), the desired margin for safety and speed of building up a contingency reserve, and the availability of other sources of capital to cover excessive losses. The nature of flood risks is such that, because of the potential at any time for catastrophic losses, charging premium rates that reflect the full risk cannot ensure that the NFIP will not have to borrow from Treasury again in the future. As a corollary, the need in any particular year to borrow from Treasury does not, by itself, necessarily indicate that the rates charged were inappropriate or that the program was not being run properly.

[9]The Preferred Risk Policy offers low-cost flood insurance to owners and tenants of residential and nonresidential buildings located in moderate- to low-risk areas as long as the property has not, within any 10-year period, incurred two or more flood insurance claim payments or disaster relief payments (including loans and grants) of more than $1,000 each.

catastrophic losses, as occurred in 2005, and may need to borrow from Treasury to pay claims in those years.[10]

Increasing premium rates to fully reflect the risk of loss—including the risk of catastrophic loss—would generally require reducing or eliminating subsidized and grandfathered rates and offers several advantages. Specifically, increasing rates could:

- result in premium rates that more fully reflected the actual risk of loss;
- decrease costs for taxpayers by reducing costs associated with postdisaster borrowing to pay claims; and
- encourage private market participation, because the rates would more closely approximate those that would be charged by private insurers.

However, eliminating subsidized and grandfathered rates and increasing rates overall would increase costs to some homeowners, who might then cancel their flood policies or elect not to buy them at all. According to FEMA, subsidized premium rates are generally 40 percent to 45 percent of rates that would reflect the full risk of loss. For example, the projected average annual subsidized premium was $1,121 as of October 2010, discounted from the $2,500 to $2,800 that FEMA said would be required to cover the full risk of loss.[11] In a 2009 report, we also analyzed the possibility of creating a catastrophic loss fund within NFIP (one way to help pay for catastrophic losses).[12] Our analysis found that in order to create a fund equal to 1 percent of NFIP's total exposure by 2020, the average subsidized premium—which typically is in one of the highest-risk zones—would need to increase from $840 to around $2,696, while the average full-risk premium would increase from around $358 to $1,149.

[10]Implementing rates that reflect the full risk of loss, including catastrophic losses, might not eliminate NFIP's need to borrow funds for larger-than-expected losses that occurred before sufficient reserves had been built.

[11]This premium that would be required to cover the full risk of loss is based upon FEMA's calculation that subsidized premium rates are generally 40 percent to 45 percent of those rates.

[12]See GAO, *Information on Proposed Changes to the National Flood Insurance Program*, GAO-09-420R (Washington, D.C.: Feb. 27, 2009). The creation of a catastrophic loss fund might not eliminate NFIP's need to borrow funds for larger-than-expected losses that occurred before the fund had been built. Further borrowing could require either a longer period to rebuild the loss fund or debt forgiveness from Congress.

Such steep increases could reduce participation, either because homeowners could no longer afford their policies or simply deemed them too costly, and increase taxpayer costs for postdisaster assistance to property owners who no longer had flood insurance.

However, a variety of actions could be taken to mitigate these disadvantages. For example, subsidized rates could be phased out over time or not transferred with the property when it is sold. Moreover, as we noted in our past work, targeted assistance could be offered to those most in need to help them pay increased NFIP premiums.[13] This assistance could take several forms, including direct assistance through NFIP, tax credits, or grants. In addition, to the extent that those who might forgo coverage were actually required to purchase it, additional actions could be taken to better ensure that they purchased policies. According to the RAND Corporation, in SFHAs, where property owners with loans from federally insured or regulated lenders are required to purchase flood insurance, as few as 50 percent of the properties had flood insurance in 2006.[14]

## Limiting Taxpayer Costs Could Be Achieved by Increasing Premium Rates, but Further Mitigation Efforts Could Incur Up-Front Costs

In order to reduce expenses to taxpayers that can result when NFIP borrows from Treasury, NFIP needs to be able to generate enough in premiums to pay its claims, even in years with catastrophic losses—a goal that is closely tied to that of eliminating subsidies and other reduced rates. Since the program's inception, NFIP premiums have come close to covering claims in average loss years but not in years of catastrophic flooding, particularly 2005. Unlike private insurance companies, NFIP does not purchase reinsurance to cover catastrophic losses.[15] As a result, NFIP has funded such losses after the fact by borrowing from Treasury. As we have seen, such borrowing exposes taxpayers to the risk of loss. NFIP still owes approximately $17.8 billion of the amount it borrowed from Treasury for losses incurred during the 2005 hurricane season. The high cost of servicing this debt means it may never be repaid, could in fact increase,

[13]See GAO, *Flood Insurance: Options for Addressing the Financial Impact of Subsidized Premium Rates on the National Flood Insurance Program*, GAO-09-20 (Washington, D.C.: Nov. 14, 2008).

[14]RAND, *The National Flood Insurance Program's Market Penetration Rate: Estimates and Policy Implications* (Santa Monica, Calif.: 2006).

[15]Reinsurance is essentially insurance for insurers—that is, companies buy coverage for all or a part of a policy's liability from other insurers in order to offset exposure.

and will continue to affect the program's solvency and be a burden to taxpayers.

Another way to limit costs to taxpayers is to decrease the risk of losses by undertaking mitigation efforts that could reduce the extent of damage from flooding. FEMA has taken steps to help homeowners and communities mitigate properties by making improvements designed to reduce flood damage—for example, elevation, relocation, and demolition. As we have reported, from fiscal year 1997 through fiscal year 2007, nearly 30,000 properties were mitigated using FEMA funds.[16] Increasing mitigation efforts could further reduce flood damage to properties and communities, helping to put NFIP on a firmer financial footing and reducing taxpayers' exposure.

FEMA has made particular efforts to address the issue of repetitive loss properties through mitigation. These properties account for just 1 percent of NFIP's insured properties but are responsible for 25 percent to 30 percent of claims. Despite FEMA's efforts, the number of repetitive loss properties increased from 76,202 in 1997 to 132,100 in March 2011, or by about 73 percent. FEMA also has some authority to raise premium rates for property owners who refuse mitigation offers in connection with the Severe Repetitive Loss Pilot Grant Program.[17] In these situations, FEMA can initially increase premiums to up to 150 percent of their current amount and may raise them again (by up to the same amount) on properties that incur a claim of more than $1,500. However, FEMA cannot increase premiums on property owners who pay the full-risk rate but refuse a mitigation offer, and in no case can rate increases exceed the full-risk rate for the structure. In addition, FEMA is not allowed to discontinue coverage for those who refuse mitigation offers. As a result, FEMA is limited in its ability to compel owners of repetitive loss properties to undertake flood mitigation efforts.

[16]See GAO-09-20.

[17]Under this program, for single-family properties, a severe repetitive loss is defined as a property covered under a contract for flood insurance that has incurred flood-related damage (1) for which four or more separate claims payments have been made, with the amount of each claim exceeding $5,000, and with the cumulative amount of such claims payments exceeding $20,000, or (2) for which at least two separate claims payments have been made, with the cumulative amount of such claims exceeding the value of the property. 42 U.S.C. § 4102a(b).

Mitigation offers significant advantages. As I have noted, mitigated properties are less likely to be at a high risk for flood damage, making it easier for NFIP to charge them full-risk rates that cover actual losses. Allowing NFIP to deny coverage to owners of repetitive loss properties who refused to undertake mitigation efforts could further reduce costs to the program and ultimately to taxpayers.

One disadvantage of increased mitigation efforts is that they can impose up-front costs on homeowners and communities required to undertake them and could raise taxpayers' costs if the federal government elected to provide additional mitigation assistance. Those costs could increase still further if property owners who were dropped from the program for refusing to mitigate later-received federal postdisaster assistance. These trade-offs are not insignificant, although certain actions could be taken to reduce them. For example, federal assistance such as low-cost loans, grants, or tax credits could be provided to help property owners pay for the up-front costs of mitigation efforts. Any reform efforts could explore ways to improve mitigation efforts to help ensure maximum effectiveness. For example, FEMA has three separate flood mitigation programs.[18] Having multiple programs may not be the most cost-efficient and effective way to promote mitigation and may unnecessarily complicate mitigation efforts.

## Depending on How They Were Implemented, Efforts to Encourage Broader Participation Could Reduce Costs

Increasing participation in NFIP, and thus the size of the risk pool, would help ensure that losses from flood damage did not become the responsibility of the taxpayer. Participation rates have been estimated to be as low as 50 percent in SFHAs, where property owners with loans from federally insured and regulated lenders are required to purchase flood insurance, and participation in lower-risk areas is significantly lower.[19] For example, participation rates outside of SFHAs have been found to be as low as 1 percent, leaving significant room to increase participation.

Expanding participation in NFIP would have a number of advantages. As a growing number of participants shared the risks of flooding, premium

[18] These programs include the Flood Mitigation Assistance Program, the Repetitive Flood Claims Program, and the Severe Repetitive Loss Program. Moreover, the Hazard Mitigation Grant Program and the Pre-Disaster Mitigation Program are two additional hazard mitigation programs that are not specific to flooding.

[19] RAND, *The National Flood Insurance Program's Market Penetration Rate.*

rates could be lower than they would be with fewer participants. Currently, NFIP must take all applicants for flood insurance, unlike private insurers, and thus is limited in its ability to manage its risk exposure. To the extent that properties added to the program were in geographic areas where participation had historically been low and in low- and medium-risk areas, the increased diversity could lower rates as the overall risk to the program decreased. Further, increased program participation could reduce taxpayer costs by reducing the number of property owners who might draw on federally funded postdisaster assistance.

However, efforts to expand participation in NFIP would have to be carefully implemented, for several reasons. First, as we have noted, NFIP cannot reject applicants on the basis of risk. As a result, if participation increased only in SFHAs, the program could see its concentration of high-risk properties grow significantly and face the prospect of more severe losses. Second, a similar scenario could emerge if mandatory purchase requirements were expanded and newly covered properties were in communities that did not participate in NFIP and thus did not meet standards—such as building codes—that could reduce flood losses. As a result, some of the newly enrolled properties might be eligible for subsidized premium rates or, because of restrictions on how much FEMA can charge in premiums, might not pay rates that covered the actual risk of flooding. Finally, historically FEMA has attempted to encourage participation by charging lower rates; however, doing so results in rates that do not fully reflect the risks of flooding and exposes taxpayers to increased risk.

Moderating the challenges associated with expanding participation could take a variety of forms. Newly added properties could be required to pay full-risk rates, and low-income property owners could be offered some type of assistance to help them pay their premiums. Outreach efforts would need to include areas with low and moderate flood risks to help ensure that the risk pool remained diversified. For example, FEMA's goals for NFIP include increasing penetration in low-risk flood zones, among homeowners without federally related mortgages in all zones, and in geographic areas with repetitive losses and low penetration rates.

## Encouraging Private Market Participation Could Reduce the Federal Government's Exposure but Could Also Decrease NFIP's Stability if Only High-Risk Properties Remained

Currently, the private market provides only a limited amount of flood insurance coverage. In 2009, we reported that while aggregate information was not available on the precise size of the private flood insurance market, it was considered relatively small.[20] The 2006 RAND study estimated that 180,000 to 260,000 insurance policies for both primary and gap coverage were in effect.[21] We also reported that private flood insurance policies are generally purchased in conjunction with NFIP policies, with the NFIP policy covering the deductible on the private policy. Finally, we reported that NFIP premiums were generally less expensive than premiums for private flood insurance for similar coverage.[22] For example, one insurer told us that for a specified amount of coverage for flood damage to a structure, an NFIP policy might be as low as $500, while a private policy might be as high as $900. Similar coverage for flood damage to contents might be $350 for an NFIP policy but around $600 for a private policy.

Given the limited nature of private sector participation, encouraging private market participation could transfer some of the federal government's risk exposure to the private markets and away from taxpayers. However, identifying ways to achieve that end has generally been elusive. In 2007, we evaluated the trade-offs of having a mandatory all-perils policies that would include flood risks.[23] For example, it would alleviate uncertainty about the types of natural events homeowners insurance covered, such as those that emerged following Hurricane Katrina. However, at the time the industry was generally opposed to an all-perils policy because of the large potential losses a mandatory policy would entail.

Increased private market participation is also not without potential disadvantages. First, if the private markets provide coverage for only the lowest-risk properties currently in NFIP, the percentage of high-risk properties in the program would increase. This scenario could result in higher rates as the amount needed to cover the full risk of flooding increased. Without higher rates, however, the federal government would face further exposure to loss. Second, private insurers, who are able to charge according to risk, would likely charge higher rates than NFIP has

[20]See GAO-09-420R.

[21]RAND, *The National Flood Insurance Program's Market Penetration Rate.*

[22]See GAO-09-420R.

[23]See GAO-08-7.

been charging unless they received support from the federal government. As we have seen, such increases could create affordability concerns for low-income policyholders. Strategies to help mitigate these disadvantages could include requiring private market coverage for all property owners—not just those in high-risk areas—and, as described earlier, providing targeted assistance to help low-income property owners pay for their flood coverage. In addition, Congress could provide options to private insurers to help lower the cost of such coverage, including tax incentives or federal reinsurance.

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

As Congress weighs NFIP's various financial challenges in its efforts to reform the program, it must also consider a number of operational and management issues that may limit efforts to meet program goals and impair NFIP's stability. For the past 35 years, we have highlighted challenges with NFIP and its administration and operations. For example, most recently we have identified a number of issues impairing the program's effectiveness in areas that include the reasonableness of payments to Write-Your-Own (WYO) insurers, the adequacy of financial controls over the WYO program, and the adequacy of oversight of non-WYO contractors. In our report, which reviews FEMA's management of NFIP, we addressed, among other things, (1) the extent to which FEMA's management practices affect the agency's ability to meet NFIP's mission and (2) lessons to be learned from the cancellation of FEMA's most recent attempt to modernize NFIP's flood insurance policy and claims processing system.[24]

We found that FEMA faces significant management challenges in areas that affect its administration of NFIP. First, FEMA has not finalized strategic guidance and direction for NFIP and therefore lacks goals and objectives for the program and the necessary starting point for developing performance measures that would assess the program's effectiveness. Second, FEMA faces a number of human capital challenges related to turnover, hiring, and tracking the many contractors that play a key role in NFIP. Further, FEMA lacks a plan that would help ensure consistent day-to-day operations when it deploys staff to respond to federal disasters. Third, collaboration between program and support offices that contribute to administering NFIP has at times been ineffective, leading to challenges in effectively carrying out some key functions, including information

[24]See GAO-11-297.

technology, acquisition, and financial management. Finally, FEMA does not have a comprehensive set of processes and systems to guide its operations. Specifically, it lacks an updated records management policy, an electronic document management system, procedures to effectively manage unliquidated obligations, and a fully developed and implemented documentation of its business processes. FEMA has begun taking steps to improve its acquisition management and document some of its business processes, but the results of its efforts remain to be seen. Unless it takes further steps to address these management challenges, FEMA will be limited in its ability to manage NFIP's operations or better ensure program effectiveness. In our report we made eight recommendations addressing these issues. DHS agreed with these recommendations and FEMA has begun to take steps to begin addressing some of them. For example, FEMA has begun developing a strategy for the administration of its mitigation and insurance programs, conducting a workforce assessment, holding outreach sessions between program and support offices to improve collaboration, and developing training and certification programs for acquisition management.

We also found that the cancelled development of the Next Generation Flood Insurance Management System (NextGen), FEMA's latest attempt to modernize NFIP's insurance policy and claims management system, illustrated weaknesses in NFIP's acquisition management activities. Despite investing roughly 7 years and $40 million, FEMA ultimately canceled the effort in November 2009 because it failed to meet user expectations, forcing the agency to continue relying on a 30-year-old system that does not fully support NFIP's mission needs and is costly to maintain and operate. A number of acquisition management weaknesses led to NextGen's failure and cancellation. Specifically, business and functional requirements were not sufficiently defined; system users did not actively participate in determining the requirements for the development of system prototypes or in pilot testing activities; test planning and project risks were not adequately managed; and project management office staffing was limited. As FEMA begins a new effort to modernize the existing legacy system, it plans to apply lessons learned from its NextGen experience. While FEMA has begun implementing some changes to its acquisition management practices, it remains to be seen if they will help FEMA avoid some of the problems that led to NextGen's failure. Unless it develops appropriate acquisitions processes and applies lessons learned from the NextGen failure, FEMA will be unable to develop an effective policies and claims processing system for NFIP. DHS agreed with our recommendations that DHS provide regular oversight of FEMA's next attempt to modernize the system and help ensure FEMA applies lessons learned.

## Closing Comments

Congressional action is needed to increase the financial stability of NFIP and limit taxpayer exposure. GAO previously identified four public policy goals that can provide a framework for crafting or evaluating proposals to reform NFIP. First, any congressional reform effort should include measures for charging premium rates that accurately reflect the risk of loss, including catastrophic losses. Meeting this goal would require changing the law governing NFIP to reduce or eliminate subsidized rates, limits on annual rate increases, and grandfathered or other rates that do not fully reflect the risk of loss. In taking such a step, Congress may choose to provide assistance to certain property owners, and should consider providing appropriate authorization and funding of such incentives to ensure transparency. Second, because of the potentially high costs of individual and community mitigation efforts, which can reduce the frequency and extent of flood damage, Congress may need to provide funding or access to funds for such efforts and consider ways to improve the efficiency of existing mitigation programs. Moreover, if Congress wished to allow NFIP to deny coverage to owners of properties with repetitive losses who refuse mitigation efforts, it would need to give FEMA appropriate authority. Third, Congress could encourage FEMA to continue to increase participation in the program by expanding targeted outreach efforts and limiting postdisaster assistance to those individuals who choose not to mitigate in moderate- and high-risk areas. And finally, to address the goal of encouraging private sector participation, Congress could encourage FEMA to explore private sector alternatives to providing flood insurance or for sharing insurance risks, provided such efforts do not increase taxpayers' exposure.

For its part, FEMA needs to take action to address a number of fundamental operational and managerial issues that also threaten the stability of NFIP and have contributed to its remaining on GAO's high-risk list. These include improving its strategic planning, human capital planning, intra-agency collaboration, records management, acquisition management, and information technology. While FEMA continues to make some progress in some areas, fully addressing these issues is vital to its long-term operational efficiency and financial stability.

Chairman Johnson and Ranking Member Shelby, this concludes my prepared statement. I would be pleased to respond to any of the questions you or other members of the Committee may have at this time.

## GAO Contact and Staff Acknowledgments

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

# Related GAO Products

*FEMA: Action Needed to Improve Administration of the National Flood Insurance Program*. GAO-11-297. Washington, D.C.: June 9, 2011.

*Flood Insurance: Public Policy Goals Provide A Framework for Reform*. GAO-11-429T. Washington, D.C.: March 11, 2011.

*FEMA Flood Maps: Some Standards and Processes in Place to Promote Map Accuracy and Outreach, but Opportunities Exist to Address Implementation Challenges*. GAO-11-17. Washington, D.C.: December 2, 2010.

*National Flood Insurance Program: Continued Actions Needed to Address Financial and Operational Issues*. GAO-10-1063T. Washington, D.C.: September 22, 2010.

*National Flood Insurance Program: Continued Actions Needed to Address Financial and Operational Issues*. GAO-10-631T. Washington, D.C.: April 21, 2010.

*Financial Management: Improvements Needed in National Flood Insurance Program's Financial Controls and Oversight*. GAO-10-66. Washington, D.C.: December 22, 2009.

*Flood Insurance: Opportunities Exist to Improve Oversight of the WYO Program*. GAO-09-455. Washington, D.C.: August 21, 2009.

*Information on Proposed Changes to the National Flood Insurance Program*. GAO-09-420R. Washington, D.C.: February 27, 2009.

*High-Risk Series: An Update*. GAO-09-271. Washington, D.C.: January 2009.

*Flood Insurance: Options for Addressing the Financial Impact of Subsidized Premium Rates on the National Flood Insurance Program*. GAO-09-20. Washington, D.C.: November 14, 2008.

*Flood Insurance: FEMA's Rate-Setting Process Warrants Attention*. GAO-09-12. Washington, D.C.: October 31, 2008.

*National Flood Insurance Program: Financial Challenges Underscore Need for Improved Oversight of Mitigation Programs and Key Contracts*. GAO-08-437. Washington, D.C.: June 16, 2008.

*Natural Catastrophe Insurance: Analysis of a Proposed Combined Federal Flood and Wind Insurance Program.* GAO-08-504. Washington, D.C.: April 25, 2008.

*National Flood Insurance Program: Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed.* GAO-08-28. Washington, D.C.: December 28, 2007.

*National Disasters: Public Policy Options for Changing the Federal Role in Natural Catastrophe Insurance.* GAO-08-7. Washington, D.C.: November 26, 2007.

*Federal Emergency Management Agency: Ongoing Challenges Facing the National Flood Insurance Program.* GAO-08-118T. Washington, D.C.: October 2, 2007.

*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.

*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 12, 2007.

*Coastal Barrier Resources System: Status of Development That Has Occurred and Financial Assistance Provided by Federal Agencies.* GAO-07-356. Washington, D.C.: March 19, 2007.

*Budget Issues: FEMA Needs Adequate Data, Plans, and Systems to Effectively Manage Resources for Day-to-Day Operations.* GAO-07-139. Washington, D.C.: January 19, 2007.

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

*GAO'S High-Risk Program.* GAO-06-497T. Washington, D.C.: March 15, 2006.

*Federal Emergency Management Agency: Challenges for the National Flood Insurance Program.* GAO-06-335T. Washington, D.C.: January 25, 2006.

*Federal Emergency Management Agency: Improvements Needed to Enhance Oversight and Management of the National Flood Insurance Program*. GAO-06-119. Washington, D.C.: October 18, 2005.

*Determining Performance and Accountability Challenges and High Risks*. GAO-01-159SP. Washington, D.C.: November 2000.

*Standards for Internal Control in the Federal Government*. GAO/AIMD-00-21.3.1. Washington, D.C.: November 1999.

*Budget Issues: Budgeting for Federal Insurance Programs*. GAO/T-AIMD-98-147. Washington, D.C.: April 23, 1998.

*Budget Issues: Budgeting for Federal Insurance Programs*. GAO/AIMD-97-16. Washington, D.C.: September 30, 1997.

*National Flood Insurance Program: Major Changes Needed If It Is To Operate Without A Federal Subsidy*. GAO/RCED-83-53. Washington, D.C.: January 3, 1983.

*Formidable Administrative Problems Challenge Achieving National Flood Insurance Program Objectives*. RED-76-94. Washington, D.C.: April 22, 1976.

## GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

### Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, http://www.gao.gov/ordering.htm.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

## Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

## Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

## PREPARED STATEMENT OF CHAD BERGINNIS

ASSOCIATE DIRECTOR, ASSOCIATION OF STATE FLOODPLAIN MANAGERS

JUNE 23, 2011

### Introduction

The Association of State Floodplain Managers (ASFPM) is very pleased to offer our thoughts and recommendations regarding the reauthorization and reform of the National Flood Insurance Program (NFIP). We thank Chairman Johnson and Ranking Member Shelby for your attention to the importance of providing reauthorization and guidance for the future direction of the program. We appreciate the opportunity to share with you observations about the current status of the NFIP, challenges the program confronts and opportunities to improve our Nation's efforts to reduce flood-related losses.

We are hopeful that this Congress can provide stability for the NFIP while also moving the program in the direction of needed improvements and adjustments. We note that extensive work in both the House and Senate in the 110th Congress did not result in final action on reform legislation and legislation passed by the House in the 111th Congress also did not result in final legislative action. Since then, other issues have emerged and actions have been taken by the Federal Emergency Management Agency that point to the need to update those earlier reform and revision proposals and to seriously consider further and possibly significant NFIP reform ideas.

The convergence of several areas of concern, in particular new flood maps, accreditation status of levees, and affordability of flood insurance, has focused considerable attention on challenges faced by the NFIP. We believe this creates an opportunity to better manage flood risk, to better protect lives and property and to help communities and individual citizens restore their economic and personal lives more fully and quickly after a flood disaster.

### Central Question

*Perhaps the central question for the Congress to consider during reauthorization of the NFIP is what the program is expected to do and what it should be expected to do in the future?*

We are all well aware that the program is in debt to the Nation's taxpayers for $17.6 billion after being overwhelmed by claims following flood damage resulting from the major hurricanes of 2004 and 2005. Floods are our Nation's most frequent and, overall, most costly disasters. We also know that due to the ever-changing climate, scientists predict that some parts of the country are expected to experience more frequent and more intense storms in the future, and that sea-level rise along the coasts of the United States will result in oceans being at least several feet higher by 2100. Given this, should the NFIP be expected to cover all claims associated with catastrophic losses or should the program be expected to cover claims in the average annual loss year with catastrophic losses handled in some other manner.

How Congress decides the answer to this question is central to the way in which future reforms to the NFIP should be framed.

### About ASFPM

Members of the Association of State Floodplain Managers (ASFPM) are the Federal Emergency Management Agency's (FEMA's) partners in coordinating and implementing the insurance, risk identification and hazard mitigation components of the NFIP. ASFPM and its 30 Chapters represent over 14,000 State and local officials and other professionals who are engaged in all aspects of floodplain management and hazard mitigation, including management, mapping, engineering, planning, community development, hydrology, forecasting, emergency response, water resources, and insurance for flood risk. All ASFPM members are concerned with working to reduce our Nation's flood-related losses. Many of our State members are designated by their governors to coordinate and implement the National Flood Insurance Program, and many others are involved in the administration and implementation of FEMA's mitigation programs. For more information on the Association, our Web site is: *http://www.floods.org.*

### The NFIP and Benefits to Communities, Policyholders, and Taxpayers

*Intentions*

The National Flood Insurance Program was enacted into law in 1968 following several years of policy development. The private insurance industry was not writing flood insurance policies as it was not deemed to be a profitable enterprise and potential flooding areas had not been identified and mapped making quantification of risk difficult. Taxpayers paid the bills for Disaster Relief following flood disasters. The original purposes of the NFIP were several:

- to require those living in at-risk locations to pay for a portion of their risk through insurance premiums;
- to reduce dependency on disaster assistance and save the taxpayers' money by requiring insurance in at-risk locations;
- to make flood victims closer to whole following a disaster than they would be with only disaster relief;
- to reduce flood related losses over time by requiring participating communities to adopt ordinances to guide development in areas at risk of flooding; and
- to identify areas at risk of flooding for the dual purposes of knowing where to require the purchase of flood insurance and of guiding development and building practices to save lives and reduce property damage.

As originally authorized, rates were to be affordable to encourage broader participation in the program, thereby expanding the base of policyholders. Properties built before issuance of Flood Insurance Rate Maps (FIRMs) would have flood insurance available at lower, "subsidized" rates based on the presumption that the builder and property owner were not aware of the flood risk. It was thought that, over time, the number of such subsidized properties would diminish because they would be substantially damaged by floods or would be demolished for other reasons. In the early years, some 70 percent of policies were subsidized. Currently, only about 23 percent are subsidized, and the remaining are charged actuarial rates based on risk. As authorized, the NFIP does not incorporate the potential for catastrophic losses in the rate structure. Rather, to pay for claims that exceeded the resources of the National Flood Insurance Fund, the program is authorized to borrow, with interest, from the U.S. Treasury. Prior to the 2004 and 2005 hurricane seasons the NFIP had built a strong reputation for repayment.

**Results Thus Far**

The Association of State Floodplain Managers concludes that the NFIP has been successful in meeting a number of its original objectives, but less so in reducing total flood losses in the Nation. The statute does mandate lenders to require certain borrowers to obtain flood insurance, sparing taxpayers from paying many millions of dollars in disaster relief and casualty loss deductions, and enabling those citizens with flood insurance to more fully restore their lives to normalcy after a disaster. Additionally, the NFIP has prevented some unwise development and promoted flood hazard mitigation through local adoption of floodplain management ordinances. On the other hand, too many Americans continue to build in at-risk locations, including residual risk areas behind flood control structures and high risk coastal areas. Thus collective flood losses for the Nation continue to increase in real dollars. In the first decade of this century, average yearly flood losses have increased from $6 billion to $10 billion.

Over the 40-plus years of the NFIP, there have been revisions and reforms, but the program has, in large part, functioned as it was designed to function. The original framers did not require the NFIP to set rates for truly catastrophic flooding associated with extreme events like Hurricane Katrina, or to have reserves to cover the fiscal impact such events would have on the program. A significant, often unrecognized, and difficult to measure benefit of the NFIP is the number of decisions people have made to build on higher ground and the damage that does not occur because buildings have been built to resist flood damage. For those who decide to build in mapped flood hazard areas, FEMA estimates that meeting the NFIP standards prevents over $2 billion in damage each year.

However, issues have emerged which now necessitate some reevaluation of the scope of the program and some significant readjustments to better meet the original and still valid purposes.

**Emerging Issues**

The program has saved taxpayer dollars in disaster relief and, until recently, flood claims have been covered by premium and fee revenues or by Treasury borrowing which was repaid with interest. (In the 1980s, approximately $2 billion in borrowing was forgiven.) The rate structure was generally sufficient to cover the costs of the average loss year. Currently, however, the program has a debt of approximately $17.75 billion. The FEMA Administrator has testified that full repayment from current revenues is unlikely. This leads to questions about how the program should cope with catastrophic losses in the future and about how to put the program back on solid footing.

Enforcement of local floodplain management ordinances, land-use regulations (*i.e.,* subdivision and zoning codes) and building codes has reduced flood losses. However, other policies in some cases, including levee construction, have had the opposite effect of encouraging development in areas that still have a residual flood risk and where the consequences are dramatic when flooding occurs. Incentives for communities and property owners to take steps to mitigate future flood losses have not been sufficient. As a result, flood losses in the Nation continue to increase.

Concern about the debt has led to calls to increase premiums and to take other steps to reduce exposure and increase revenues. In particular, there have been calls to move certain properties that currently receive "subsidized" rates to full actuarial rates. However, this feeds existing concerns about affordability of flood insurance. Can the program be fiscally sound and still have affordable rates?

Concerns about affordability have played an important role in response to issuance of new, updated flood risk maps and to decertification of levees, which is beginning to interfere with improved identification of risk because of the related requirement to purchase flood insurance. Identification of risk is key to both providing property owners with the insurance protection they need as well as to facilitating appropriate construction techniques and loss mitigation activities.

When Map Modernization began in 2003, most flood maps were between 15 and 30 years old. The Map Modernization program, which ended in 2009, focused primarily on bringing modernized maps to a current and consistent digital platform while only focusing some effort on identifying new flood hazard areas and updating the maps with new engineering studies. Also, levees were analyzed for their ability to provide flood protection based on current engineering and design standards on a national level—which hadn't previously been done on such a large scale. One of the lessons learned under Map Modernization is that outreach and data are critical to help communities understand flood risk. Another is that the publication of new flood maps with old engineering data and methods casts doubt as to the credibility of the maps overall. In reflection, the digital conversion of the flood maps was an important and necessary step to bring the national inventory of flood maps into a modern platform; however, that step alone is not the final answer. Many maps have been converted to digital format but significant work remains to update them with new engineering studies to reflect the effects of increased watershed development and increased storm intensity on flood hazards.

Why is new engineering and risk data so important? When new and improved engineering models are used, when data is updated to reflect changes from watershed development, when additional stream gage and precipitation data are incorporated to better reflect changing storm intensity and watershed runoff patterns, and when better topographic data is used, you get a better flood map. The result? The poor condition of much of the Nation's infrastructure, including levees, dams, and other flood control structures, as well as stormwater facilities, has become much more evident. Updated flood maps more accurately reflect the floodplain by showing some areas as now in 100-year flood hazard areas and, conversely, by showing many areas as no longer in the 100-year flood hazard areas. (It is important to note that, to date, approximately as many properties are newly shown as out of a Special Flood Hazard Area (SFHA) as are newly shown as in the SHFA due largely to improved topographic mapping.)

Under FEMA's RiskMAP program, which has replaced Map Modernization, there is more focus on providing new engineering data as well as providing adequate flood risk data and outreach to communities. The mapping program has evolved to incorporate some of the lessons learned under Map Modernization. Newly designed map products will provide much more risk information for areas both inside and outside the 100-year flood hazard area which will enable citizens and communities to make better decisions about management of risk. New maps will also reflect whether levees are reliable which can change the hazard designation behind the levee. However, budgetary limitations threaten to significantly slow the process of making RiskMAP products available. The National Flood Insurance Fund pays the administrative costs of the NFIP, but does not collect enough in policy fee income to pay the full cost of mapping and risk identification. This has necessitated the appropriation of funds for the Map Modernization Initiative and now the RiskMAP program to supplement the funds available from policy fees associated with premiums.

The use of the 100-year flood (or 1 percent annual chance flood) for designation of the Special Flood Hazard Areas (SFHAs) has led to overreliance on this artificial boundary and underestimation of flood risk beyond that boundary. Currently, 25 percent of flood claims are paid on properties located outside of the mapped SHFA. Improved awareness of risk beyond the SFHA boundary is necessary along with better communication about the affordability of policies in these areas. Whether these areas lie outside of the natural floodplain or exist behind levees, downstream of dams, or in designated floodways of major flood control systems, these areas are at risk from flooding. And that risk can be catastrophic in the case of areas behind levees or downstream of dams.

**Reforms for the Congress To Consider**

The Association of State Floodplain Managers has been very pleased that FEMA, at the direction of Administrator Craig Fugate, has undertaken a "Re-Thinking the NFIP" analysis. A report to the Congress on the options reviewed is expected this summer. Some of those options and possible reforms from this analysis could be acted on by the Congress, but others will undoubtedly require further study and research. ASFPM recommends that this Committee seriously evaluate FEMA's findings. At this time, our suggestions range from larger issues to smaller adjustments:

1. ASFPM recommends that the Congress clarify whether or not the NFIP should be structured to accommodate catastrophic losses, as discussed at the beginning of this testimony. Many reform decisions would flow from this clarification.

2. Authorization of an ongoing flood mapping program is needed. The Senate-passed 2008 bill included a well-conceived section providing such an authorization and outlining important mapping activities. It is important that the section authorize the continuation of an annual appropriation in addition to funds available from policy fee and map fee revenue. The 2008 act would have authorized establishment of a Technical Mapping Advisory Committee of key NFIP stakeholders much like the one authorized in the 1994. That body proved to be very effective and its reports led to development of the Map Modernization Initiative.

3. The Severe Repetitive Loss Program (SRL) was established in the 2004 Flood Insurance Reform Act as one component of a three part approach to diminish the problem of repetitive loss claims by mitigating these properties. SRL has not been fully effective largely because the statutory provisions establishing the program are so prescriptive that FEMA's ability to design an effective program was limited. The statutory requirements also heavily burdened States and communities to the point that some declined to participate. Statutory changes are needed to simplify the program and make it more attractive to States and communities.

The SRL program is intended as a fiscally responsible means of investing funds from the National Flood Insurance Fund (NFIF) to reduce the approximately $200 million per year drain on the fund represented by properties that have received multiple claims. Instead of simply reauthorizing the SRL program, we recommend that the well-received Flood Mitigation Assistance (FMA) program be expanded to include the focus and funding from both SRL and another component, the Repetitive Flood Claims (RFC) program. The combined program would retain the authorized level of funding (by transfer from the NFIF) for each component provided in the 2004 Flood Insurance Reform Act—$40 million for mitigation of severe repetitive loss structures (defined in statute), $40 million for FMA and $10 million for certain properties in certain communities. This would have the effect of simplifying administration so that the unobligated balance in the program can be put to its intended use of reducing claims from severe repetitive loss properties.

4. Improved flood hazard mitigation incentives are needed. ASFPM suggests that better linkages between premium rates and mitigation actions must be encouraged. We support the suggestions made by FEMA Administrator Fugate for a community-based risk assessment system involving payment by the community for a community policy. As the Administrator said, " Incentives could be structured to encourage communities to implement flood mitigation measures in order to reduce their overall premium assessment." The Committee could direct either further research on the feasibility of this concept or direct that pilot group policies be tested.

5. As in the 2008 Senate-passed bill, the debt to the Treasury should be forgiven. Since the debt exceeds the NFIP's ability to repay, it is prudent to stabilize the program without debt and to build in reforms to improve its fiscal soundness. The definition of "actuarial premium rates" will depend on whether or not the program is to accommodate catastrophic losses.

Due to two mild hurricane seasons and a favorable refinancing of the debt, the NFIP has been able to cover claims, to pay interest on its debt, and to repay $2 billion of the original loan. However, full repayment of the debt is not a reasonable expectation because mild loss seasons cannot be expected to continue, the Nation's flood risk is increasing due to development and more intense storms, the interest on the debt will go up, and the annual program income is about $3.2 billion, from which operating expenses and claims must be paid. It is not expected that program income will change significantly unless dramatic changes are made to the NFIP's rate structure.

6. Purchase of flood insurance in residual risk areas behind levees should be mandatory.

The Senate-passed 2008 bill included such a provision. Engineers know that all levees are subject to failure or over-topping. Because of the low probability but catastrophic loss possibility, premium rates in such areas would likely be relatively low, but property owners would be protected with insurance as well as appropriate risk messaging. The report to Congress from the National Committee on Levee Safety (established by the Water Resourced Development Act of 2007) strongly recommends mandatory purchase of flood insurance behind levees.

7. The affordability issue must be addressed. Not only is the mandatory purchase requirement a financial hardship for many lower income property owners, but affordability concerns are beginning to interfere with identification of risk, related mitigation of risk and protection of public safety. Legislative suggestions for delaying map issuance or for delaying effective dates for the mandatory purchase requirement are examples. We note that the bill soon to be considered by the House of Representatives includes language which focuses and limits the application and time frame for a delay in the mandatory purchase requirement for areas newly mapped as within the SFHA. A phase-in of actuarial rates in these areas is a better approach to ease the financial burden because property owners are insured during the phase-in period rather than entirely without insurance protection.

Ideas have emerged in academic research for a means-tested system of flood insurance vouchers. ASFPM recommends that the Committee direct that an economic analysis be conducted of the overall effect on taxpayer funds of providing flood insurance vouchers to low income property owners as opposed to providing assistance through disaster relief funds. Such an analysis should include aspects such as restoration of community and economic vitality and speed of rebuilding, repair, and restoration of lifestyle.

8. ASFPM has long supported movement of policies toward actuarial rates for both for fiscal soundness and for clarity of the risk message. As we have identified earlier, however, there are affordability issues that will emerge. ASFPM also believes that robust mitigation programs can be an opportunity for property owners who are affected by such changes to help offset the resources needed to mitigate. Movement of certain classes of properties towards actuarial rates such as second homes, commercial properties and severe repetitive loss properties is consistent with ASFPM positions and this should be done so within a reasonable timeframe.

9. Exploration of additional private insurance engagement with the NFIP should be conducted. For example, the private reinsurance market could possibly provide part of the solution to the problem of catastrophic losses. We recommend studying the feasibility of purchasing some amount of reinsurance for the NFIP.

10. The NFIP should operate within a true flood risk management framework. The Committee could direct that FEMA work with other Federal agencies in the Federal Interagency Floodplain Management Task Force to develop a comprehensive flood risk management framework to improve Federal coordination toward the objective of reducing flood related losses in the Nation.

The Nation must carefully balance the issue of who benefits and who pays for development at risk. There are about 130 million housing units in the U.S. Of that, about 10 to 11 million are in flood hazard areas, with fewer than half of those carrying flood insurance. This means 90 percent of the population does not live in identified Special Flood Hazard Areas, yet they must continue to support large outlays each year for disaster relief for flooding of uninsured buildings and rebuilding damaged infrastructure in flood areas, including the possibility of having to cover the $17.75 billion debt of the NFIP. Yet those same taxpayers obtain few, if any, of the benefits of that development. This points out the need to tie program outcomes of the NFIP to these other programs such as FEMA's disaster relief programs and programs of HUD, DOT, USDA, and others.

The U.S. Army Corps of Engineers has adopted the comprehensive flood risk management approach in many of its programs at the national level. For this approach to be successful for the Nation, FEMA must also actively promote the concept and integrate its programs for the NFIP, mitigation and disaster relief internally, and must integrate them with other Federal programs that impact flood risk.

11. Future changes in flood levels and sea-level rise should be reflected in flood mapping and risk data and long term adaptation strategies should be programmed into the land use and planning provisions of the NFIP and mitigation planning. It is clear that many parts of the Nation are experiencing more intense rainfall and storm events. The Mayor of Des Moines, Iowa, relates how his community suffered a 500-year flood event in three consecutive months during the summer of 2010. Sea

levels have fluctuated over time and the current pattern shows an accelerated rise through at least the year 2100. FEMA flood maps need to reflect these future conditions so communities have the data to implement adaptation and mitigation strategies. This is essential in order for communities to be economically and socially sustainable and to incorporate resiliency in infrastructure and development now when it is incrementally less expensive *versus* later when it will be much more expensive to retrofit these facilities.

12. 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, FEMA should also delegate the authority to administer the NFIP-funded grant programs where appropriate. ASFPM continues to focus on building State capacity. We believe that those States which have developed the capacity to assume program administration are in the best position to efficiently and effectively carry out the purpose of reducing flood losses.

13. ASFPM concurs with many recommendations for a longer-term reauthorization for the NFIP to avoid the dislocations for the housing market, lenders, and insurers when the program undergoes periods of lapsed authority. In view of the "Re-Thinking the NFIP" effort, Congress could direct FEMA to perform necessary studies from the policy options for major policy reform consideration at the end of that 5-year authorization. This would facilitate the Committee taking action on FEMA's findings and recommendations in 2016.

The Association of State Floodplain Managers appreciates this opportunity to share our observations and recommendations with the Senate Committee on Banking, Housing and Urban Affairs as you consider reauthorization and reform of the National Flood Insurance Program. We look forward to answering any questions you may have and to assisting in any way that is helpful as you develop legislation.

---

## PREPARED STATEMENT OF ADAM KOLTON

EXECUTIVE DIRECTOR, NATIONAL ADVOCACY CENTER, NATIONAL WILDLIFE FEDERATION, ON BEHALF OF THE SMARTER SAFER COALITION

JUNE 23, 2011

Good Morning Chairman Johnson, Ranking Member Shelby, and Members of the Committee. I am Adam Kolton and I serve as the Executive Director of the National Advocacy Center of the National Wildlife Federation (NWF), the Nation's largest conservation education and advocacy organization with more than four million members and supporters and affiliate conservation organizations in 47 U.S. States and territories. We greatly appreciate the opportunity to offer our views on the need to reform the National Flood Insurance Program (NFIP).

At the outset let me express our concern over the impact that the recent and ongoing record breaking flooding is having on thousands of people across America's heartland. The first priority of the Federal, State, and local government is appropriately focused now on preventing loss of life, minimizing property damage, and assisting those in need with all resources possible. At the same time it's imperative that we not miss this opportunity to reform Federal policies so that we are better prepared for and can better protect people and communities from future storms and floods. In that regard, reforming the National Flood Insurance Program could not be more urgent.

National Wildlife Federation has joined forces with a uniquely diverse set of interests that includes other national conservation organizations, insurance and reinsurance companies and associations, housing advocacy groups, taxpayer and free market think tanks, and others to form the Smarter Safer coalition (list attached). While each Smarter Safer member has different underlying motivations and interests we all support the same goal—environmentally responsible, fiscally sound approaches to natural catastrophe policy that promote public safety. We all believe that the NFIP is broken and in desperate need of reform.

The unprecedented string of flooding disasters including Hurricanes Katrina, Rita, and Wilma in 2005, Hurricane Ike and the Midwest floods of 2008, the New England Floods of 2010, and this year's Midwest floods that continue to unfold along the Mississippi, Missouri, and Ohio Rivers have strained the flood program. These events caused tremendous damage, threw the program into record level debt and highlighted the limited effectiveness of the Nation's floodplain management strategy to protect property owners and reduce Federal disaster relief expenditures.

The NFIP is in the most serious trouble of its entire 43-year history and, without significant reform, it could be in danger of eventual collapse. The NFIP is currently $18 billion in debt to the U.S. Treasury, and that amount is likely to increase in the near future as a result of recent flooding. With annual revenues of only $3 billion, FEMA Administrator Fugate recently testified that it will be virtually impossible to repay the debt. The NFIP is essentially bankrupt.

The program has essentially been bailed out by U.S. taxpayers, and given the many problems the program continues to face, we have little reason to believe that without major changes this scenario will not repeat itself over and over in the future. We do not believe the public or Congress will continue to support the program under such conditions.

While the program has established some minimum standards for flood risk management, which are now in place in most communities, the NFIP has fundamentally failed to keep pace with and to substantially discourage and reduce the buildup of flood risks and damages across the Nation. It has also contributed to the deterioration and loss of important floodplain and coastal habitat areas and the serious decline of valuable and sensitive ecosystems. The NFIP minimum standards have changed little since the program was initiated over 40 years ago. Standards are so weak that even when properly enforced they virtually guarantee increasing flood losses. In addition, these standards remain in desperate need of updating, strengthening and reform.

The NFIP was originally founded on a strategy developed by eminent scientists and Government officials in the early 1960s, which combined the ideas of identifying flood risks (generally through mapping), developing and implementing risk-reducing land use and building codes, and providing affordable insurance that was not otherwise available in the private markets. It was believed that the NFIP would slowly reduce the amount of development of the floodplain. Forty-three years later, we find major failures on each of these fronts. This is in large part due to the failure to charge actuarially sound rates, the failure to aggressively mitigate risks, and the failure to protect the vital functions that floodplains perform. National flood damages, instead of decreasing as the program's founders would have hoped, are now rising at alarming levels.

The Smarter Safer Coalition has formulated a proposal to reform the National Flood Insurance Program that we believe will better protect taxpayers; will protect environmentally sensitive areas; will ensure that people understand their true risks; and will encourage mitigation of homes, property and communities. Our proposal focuses on the following (full proposal attached):

- Flood maps must be accurate, up to date, and based on the best science available. This will ensure that people understand their true risk and will increase the confidence in FEMA's ability to accurately assess risk.
- The NFIP must charge rates that are based on true risk. This will reduce the burden on taxpayers, encourage private sector engagement, and allow market forces to direct development toward higher ground.
- Finally, the NFIP must incentivize and encourage mitigation with an increased emphasis on protection of natural ecosystem functions, in lieu of subsidizing development in environmentally sensitive areas.

My testimony today will focus on necessary reforms that must be made to ensure the survival and viability of the National Flood Insurance Program in each of these key areas: rates, mapping, and mitigation. But first, allow me to explain the National Wildlife Federation's underlying interest in the NFIP and its reform—the protection of America's floodplains.

**The NFIP Must Protect Floodplain Functions**

Floodplains, the flood-prone bottomlands that cradle rivers, streams, and oceans are where the land and the waters meet. Naturally functioning floodplains provide vital habitat for countless species. These areas provide breeding, foraging, and other life cycles and grounds for a variety of plants, insects, reptiles, amphibians, birds, and mammals. Floodplains are also crucial to the survival and recovery of many threatened and endangered species, including salmon, steelhead trout, sturgeon, and sea turtles. Alterations to floodplains, however, create multiple threats to wildlife through a range of impacts including: changing the flow and hydrology of rivers; eliminating wetlands and side channels, nesting, and other important habitat areas; straightening and deepening channels; and causing siltation, nutrient, and other water quality problems.

Additionally, floodplains, in their natural form, provide an array of environmental and public health benefits, including: reducing the number and severity of floods; fostering vegetation to limit nonpoint water pollution from storm water runoff; providing a tree canopy for shade to moderate temperature extremes in adjacent rivers and streams, which in turn increases dissolved oxygen levels and consequently improves habitat for aquatic plants and animals; allowing water to recharge underground drinking water aquifers; and providing aesthetic beauty and outdoor recreation benefits.

The current floodplain management system in the United States is not working. Instead of reducing floodplain development, one of the NFIP's original goals, it has incentivized and exacerbated development. The result has been large-scale loss and alteration of floodplains, as these important natural systems have been developed, filled, and leveed off due in part to ill-conceived NFIP policy choices. As such, land-use patterns have been altered, impairing the ability of the systems themselves to provide natural flood protection values. We are bearing the high costs of these policy failures: increased flood risk and flood intensity, habitat loss and destruction, the placement of people in harm's way, and economic devastation when floods hit. Between 1978 and 2008, the number of NFIP policies in force has nearly quadrupled from 1.4 million to 5.6 million. And as more and more properties are located in floodplains, the ecological benefits they provide are being further degraded or lost.

The Federal Government has done far too little to protect floodplains, and what it has done has too often been ineffective. Not only does the current system fail to discourage people from building and rebuilding in vulnerable locations, it also uses taxpayers' dollars to encourage and enable development by subsiding flood insurance rates and masking the true cost of risk associated with this type of development. This is the primary reason the NWF and its conservation partners take an extremely serious interest in the NFIP.

**FEMA Mapping Must Use the Best Available Science To Accurately Reflect Risk and Place a Priority on Natural Resources Protection**

The NFIP is dependent upon the accuracy of its flood insurance rate maps. They show whether a property lies within the 100-year floodplain (and in some cases, the 500-year floodplain), high-risk storm surge zone, floodway, or Coastal Barrier Resource Area and ultimately are the basis for the premiums associated with a property. The maps are key to the program's success or failure. They must be up-to-date, accurate and based on the best available science. This is why we support FEMA's Risk Map program and recognize its impact on the long term fiscal viability of the NFIP. However, we believe that Congress should mandate that maps be updated in a way that ensures they are as accurate as possible.

The Nation's floodplains are dynamic. Changes include not only natural forces, but also the impacts of development, weather patterns, and topographical changes. Areas that were previously less prone to flooding may now be at greater and increasing risk of flooding. Levees that were thought to provide 100-year (1 percent annual chance) protection a decade ago may now provide far less protection due to poor maintenance, heightened flood elevations due to increasing runoff, new development, increased weather intensity, or sea-level rise.

Since 2003, FEMA has been working to update thousands of flood maps. In addition, levees are being reviewed and in many cases decertified and losing accreditation for not meeting the required levels of protection. According to FEMA, the Nation's special flood hazard areas (SFHA) have grown in size by 7 percent. While in some cases map updates have revealed more land and housing vulnerable to flooding, in other areas fewer areas are vulnerable. In fact, the number of housing units in SFHAs has seen a net decrease of 1 percent. [1]

Not surprisingly, FEMA's map updating effort has been met with some controversy. Some homeowners now face dramatic increases to their premiums, and others are now required to purchase insurance that was not mandated in the past, despite the fact that their home hasn't moved. However, as noted above, risk levels and understanding of risk can change.

Some have suggested that FEMA delay updating maps or waive building standards. But what may make good politics generally makes horrible insurance policy—and by extension with Federal flood insurance—bad public policy. People deserve to know the cost and risks of where they live, and should be responsible for insuring against those risks. The Smarter Safer coalition strongly opposes any effort to delay map changes or mandatory purchase requirements. We believe this is not only bad policy, but it is irresponsible. If people are in harm's way, they must be informed of their risk, and they should have insurance protection. While many people believe

[1] Testimony of Craig Fugate, Administrator, Federal Emergency Management Agency, Department of Homeland Security before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives. April 21, 2010, p. 4. Available at *http://www.house.gov/apps/list/hearing/financialsvcs__dem/fugate__4-21-10.pdf.*

that the Federal Government will write blank checks after a natural disaster, in general, the Federal Government pays little for the uninsured losses of individuals. Federal disaster payments focus principally on debris clean-up and rebuilding of public structures and infrastructure, and are only available in presidentially declared disasters. Homeowners who suffer losses can access temporary assistance through FEMA and may be allowed to apply for an SBA disaster assistance loan. However, if people are not covered by flood insurance, they will often have limited resources to rebuild after a flood. If they are not required to purchase flood insurance, many fail to purchase it and they will be unable to rebuild after a flood.

To ensure that maps are accurate and fair, the Smarter Safer coalition proposes that Congress create a Technical Advisory Mapping Council. Much like the one this Committee included in its 2008 reform legislation, this council would develop new standards for flood insurance rate maps that would incorporate true risk, be graduated, and reflect both realities on the ground—both man-made and natural. Such a council should include a broad membership including representatives from all impacted Federal agencies, as well as experts with technical expertise in mapping natural and beneficial floodplain functions. This will ensure that maps are accurate and comprehensively designed to assist communities and FEMA with high quality flood hazard identification, insurance rating, and effective floodplain management.

We propose that the standards they create ensure that maps accurately detail risk, requiring that rate maps be graduated to include not only the 100-year floodplain, but also the 10-, 50-, 200-, 250-, and 500-year floodplain areas (for example) and residual risk areas and associated depths of flooding, along with other flood-related hazards and important habitat and key natural ecosystem functions areas and be graduated further to include additional risk areas. While it has been expedient to list whether a property is located in or out of a floodplain (special flood hazard area), that does not reflect real risk. We believe maps should be as graduated as possible, so that a homeowner knows if they are in a 10-year floodplain or a 70-year floodplain. The council should ensure that maps meet current topographic conditions, account for altered hydrology from fill, and reflect natural features that mitigate risk like wetlands and riparian buffers.

These standards also must address the issue of levee decertification. Like the 100-year floodplain, FEMA's rate maps are currently based on an in-out model. When a levee is no longer accredited to provide protection from a 100-year flood, FEMA's maps are redrawn as if the levee is not in existence. Again, while this may have been expedient in the past, it does not reflect real-life conditions. Our proposal will require FEMA to take into account each levee based on the level of protection each confers.

Finally, the Technical Mapping Advisory Council must address the impacts of sea-level rise and likelihood of increasing storm surges and precipitation events as it pertains to increased risk to policyholders. While members of Smarter Safer may disagree on the causes of these phenomena, we all agree that in recent years we've experienced heavier rainfall, changing patterns of snowfall, more severe hurricanes, and increasing sea levels, all of which will increase flooding risk. Across the Nation, precipitation is already more likely to fall in heavy downpours than in light sprinkles, a trend a large number of scientists expected to continue. [2] [3]

The trends are troubling:

- In the Midwest and Northeast, big storms that historically would only be seen once every 20 years are projected to happen as often as every 4 to 6 years by the end of the 21st century. [4]
- Winter precipitation is beginning to shift toward more rain instead of snow. The fraction of wintertime precipitation falling as snow declined by 9 percent since 1949 in the Western United States and 23 percent in the Northeast. The biggest

---

[2] CCSP, 2008a. "Weather and Climate Extremes in a Changing Climate, Regions of Focus: North America, Hawaii, Caribbean, and U.S. Pacific Islands", a Report by the U.S. Climate Change Science Program and the Subcommittee on Global Change Research, [Thomas R. Karl, Gerald A. Meehl, Christopher D. Miller, Susan J. Hassol, Anne M. Waple, and William L. Murray (eds.)]. Department of Commerce, NOAA's National Climatic Data Center.

[3] CCSP, 2008a. "Weather and Climate Extremes in a Changing Climate, Regions of Focus: North America, Hawaii, Caribbean, and U.S. Pacific Islands", a Report by the U.S. Climate Change Science Program and the Subcommittee on Global Change Research, [Thomas R. Karl, Gerald A. Meehl, Christopher D. Miller, Susan J. Hassol, Anne M. Waple, and William L. Murray (eds.)]. Department of Commerce, NOAA's National Climatic Data Center.

[4] *Id.*

shifts from snow to rain are in March for all regions studied, December in New England, and January along the Pacific coast.[5]

- Rain-on-snow events may become more common in some locations.[6] Recent events in the Pacific Northwest have caused extensive and notable flooding. In January 2009, tens of thousands were evacuated and major transportation routes were closed when 10 inches of rain fell over 2 days, causing major snow melt and flooding in western Washington State.[7] At the same time, scientists have been gaining confidence in projections for more intense hurricanes and tropical storms in the future, even as they continue to debate whether they can detect the signal of climate change in the records of past storms. The latest studies indicate that hurricanes will have stronger winds and more rainfall, but will become somewhat less frequent.[8]
- The mean maximum wind speed of tropical cyclones is likely to increase by 2 to 11 percent globally by the end of the century. The biggest changes may occur for the most intense storms, with the wind speeds of these storms increasing by a significantly larger percentage.[9] While these changes in wind speed may seem small, they can translate into large increases in damages. For example, a 10 percent increase in wind speed of a category four hurricane can increase damages by about 50 percent.[10]
- All climate models project more rainfall from tropical cyclones in a warmer climate. The latest projections are that rainfall from hurricanes may increase from 3 to 37 percent.[11] The average increase projected by the late 21st century is about 20 percent within 62 miles of the storm center.[12]

Sea-level rise will further increase the vulnerability of States along the Gulf and Atlantic coasts to storm-surge flooding. When a tropical storm hits, higher sea level translates into bigger storm surges that can cause flooding further inland. Sea-level rise will also endanger coastal wetlands and barrier islands that form a first line of defense and help buffer coastal areas against hurricanes and storm surges. Even in the unlikely circumstance that the characteristics of tropical cyclones do not change, scientists are highly confident that sea level is rising and that coastal areas will have a greater risk of damaging storm surge. Globally, sea level has already increased by about seven inches over the past century due to thermal expansion of water and the melting of land-based glaciers and ice.[13] Additional increases in sea level are considered inevitable; the question only remains is how much and how fast.

For these reasons, the NFIP must find a way to account for these changes to accurately assess and underwrite increased risks of flooding throughout the country. Smarter Safer strongly believes that mapping underlies the whole flood program and if maps are not accurate the program will be constantly undermined.

**Rates Must Reflect Risk**

Currently, NFIP insurance rates do not reflect actual risk of flood damage. The NFIP does not charge market-based or risk-based rates, or increase rates based on previous loss experience. The program's goal of fiscal solvency is defined as charging premiums that will generate enough revenue to cover a historical average loss year. That means catastrophic loss years are largely left out of the equation. The program covers any fiscal shortfalls by borrowing from the U.S. Treasury, which is a significant subsidy in itself, especially since the loans are virtually interest free.

Perhaps the best example of the program's failure regarding rates can be demonstrated by the alarming number of repetitive loss properties that account for payouts. In 1998, NWF completed and released a landmark report, Higher Ground, on the NFIP repetitive flood loss properties—those that have two or more paid claims of at least $1,000 each over a rolling 10-year period. At that time our report showed

---

[5] *Id.*

[6] Hamlet, A.F., and D.P. Lettenmaier, 2007. "Effects of 20th Century Warming and Climate Variability on Flood Risk in the Western U.S.", Water Resources Research 43:W06427.

[7] Mapes, L.V., January 1, 2010, 2009. "Was a Year of Weather Extremes", *The Seattle Times.*

[8] Knutson, T.R., *et al.,* 2010. "Tropical Cyclones and Climate Change", Nature Geosciences Advance Online Publication on February 21, 2010, DOI: 10.1038/NGEO779.

[9] Knutson *et al.,* 2010.

[10] CCSP, 2008a.

[11] Knutson *et al.,* 2010.

[12] *Id.*

[13] Intergovernmental Panel on Climate Change (IPCC), 2007. "Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change" [Solomon, S., D. Qin, M. Manning, Z. Chen, M. Marquis, K.B. Averyt, M. Tignor, and H.L. Miller (eds.)].

there were 74,501 repetitive loss properties in the NFIP. While only approximately 2 percent of insured properties, but with 200,182 paid claims from 1978–1995, which had cost the NFIP $2.581 billion, they represented approximately 40 percent of all claims paid. More recently, despite Congress' efforts in the 1994 and 2004 Flood Insurance Reform Acts, the total number of repetitive loss properties has grown to 153,000 repetitive loss properties with 447,700 claims that have cost the NFIP $10.692 billion. Within these properties, 9,129 properties are "severe repetitive losses" with 50,607 total losses that have cost the NFIP over $1.5 billion. These types of losses cannot be sustained.

NFIP's fiscal solvency is further challenged because properties that predate a community's involvement in the NFIP or the applicable flood insurance rate map (whichever is later) enjoy significantly subsidized rates, paying only 35 to 40 percent of their actual full-risk level premium. While the initial thought may be that because of their vulnerability these pre-FIRM (Flood Insurance Rate Map) properties wouldn't be long for this world, according to GAO in 2008, over 1.1 million properties, or 25–30 percent of the program, was subsidized. FEMA puts the percentage of properties in the NFIP receiving explicitly subsidized rates at more than 20 percent. [14]

As the Committee begins to draft a reauthorization bill, we urge you to address this issue by moving all rates towards risk-based over a 5-year period. We believe that this Committee made a good start with the Flood Insurance Reform and Modernization Act of 2007 by requiring that certain properties (including nonprimary residences; severe repetitive loss properties; commercial properties; properties damaged over 50 percent of the home's value; and properties improved by over 30 percent of the home's value) phase up to actuarial rates over 4 years, and by raising the limit of annual policy increase from 10 to 15 percent. These are great steps, but in light of recent conditions and a growing deficit, we urge the Committee to go further.

We believe that to prevent further taxpayer bailouts, and to ensure the program does not incentivize building in harmful and environmentally sensitive areas, all rates must be based on risk. The coalition believes that properties should begin paying risk-based rates, through a phase in over a period of no longer than 5 years. We understand that there may be some homeowners who are unable to pay risk-based rates; however, that population is limited. For that limited population, we recommend establishing a subsidy system; however, any subsidies should be fully divorced from the insurance rates. Subsidies could be limited to those only with true affordability issues, and could be paid for through surcharges on higher-end properties. Currently, million dollar homes receive the same subsidies as homes valued at $100,000. We believe that in this current fiscal environment, we should not be providing subsidies to people who do not need Federal assistance.

I want to stress that it is imperative that any subsidy mechanism be separate from the rate structure of the NFIP. Tying these two issues together masks and exacerbates risk. Once rates are risk-based, the program will be better positioned to encourage mitigation and the private sector will be in a position to compete with the Federal Government, helping to lower risk to the U.S. taxpayer. Until rates are risk-based, the NFIP cannot fully incentivize mitigation. Once rates are based on risk, NFIP could provide discounts if homeowners undertake mitigation that lowers their risk.

**NFIP Community Eligibility Criteria Must Reduce Flood Risk to People and Protect and Restore Natural Resources**

We urge the Committee to consider addressing the community participation eligibility criteria in the NFIP to require adequate protection or restoration of natural resources and the functions of floodplains that benefit communities and species. This current oversight misses an important opportunity to better protect the public and beneficial natural resources.

Eligibility criteria must be enhanced so that participation in the NFIP requires communities to maintain or improve the habitat and flood management values of floodplains. NWF believes that this can be addressed by taking the following principles into account. First, the program should restrict or prohibit development in floodplains in high hazard and environmentally sensitive areas unless it is shown to have no adverse effect on natural resources or can be fully and sustainably mitigated. Second, repairs or improvements to existing structures should include mitiga-

[14] United States Government Accountability Office. GAO-08-437. Report to the Ranking Member, Committee on Banking, Housing, and Urban Affairs, U.S. Senate. National Flood Insurance Program. Financial Challenges Underscore Need for Improved Oversight of Mitigation Programs and Key Contracts, p. 18.

tion for damage to natural resources. Third, all mitigation should prefer non-structural means and must account for the impacts of climate change. Fourth, voluntary buyouts of homes and businesses in high flood risk areas should be promoted with appropriate lands dedicated to open space uses. Fifth, communities participating in the NFIP should be required to strengthen land-use and building code standards and provide increased incentives to encourage communities to use higher standards. This should include requiring higher building freeboard; limiting use of floodplain fill to exempt areas from flood insurance purchase requirements; eliminating the 1-foot rise for determining floodways; greater use of open-space and low density zoning; protection of natural shorelines; identifying additional no-build zones for public safety and protecting natural floodplain functions; establishing building setbacks for maintaining flood conveyance, shoreline erosion zones, and natural channel migration; and employing low-impact development methods to prevent and/or minimize the degradation of floodplain habitat. Finally, Congress must encourage or require FEMA to bring the NFIP into compliance with the Endangered Species Act (ESA) and other conservation laws to prevent harm to ESA listed species affected by floodplain development.

**FEMA's Community Rating System Must Be Improved**

FEMA's Community Rating System is a voluntary incentive program designed to encourage communities to go beyond the minimum standards of the NFIP. If a community takes mitigation steps, the premiums of individual policyholders are reduced. However, individuals only have so much sway over the mitigation decisions of their local governments. Local government officials must have an incentive to make smart mitigation decisions. FEMA must take steps to address this shortcoming and bolster incentives for participation in the program.

One way to do this is for FEMA to offer this incentive through a voluntary, community-based flood insurance policy in which a local government holds a policy that covers homes and buildings in their jurisdiction. A local government will be more likely to undertake mitigation steps that will reduce their risk and the cost of flood insurance if they are also responsible for paying the flood insurance bill. This idea holds great potential to improve floodplain management decision making on a local level. We recommend that the Senate authorize the GAO and FEMA to study the feasibility and implementation of community-based flood insurance, including authorization for a pilot program with volunteering communities.

**The NFIP Must Encourage Mitigation of Natural Features To Protect Against Flooding**

We strongly support measures that would encourage and assist homeowners in taking steps to mitigate damage to protect their homes against natural disasters. As claims to the program increase, the need to implement techniques and activities to mitigate flood damage is reinforced. The NFIP has already encouraged this through NFIP-funded hazard mitigation grant programs, created with bipartisan support, which have successfully reduced property damage, protected floodplains, and reduced the financial burden on the program. In light of these benefits, Smarter Safer has urged Congress to streamline, consolidate, and permanently extend the NFIP-funded grant programs under the Flood Mitigation Assistance (FMA) Program.

Currently, FEMA administers three separate programs to help property owners and communities mitigate against flood damage: the Flood Mitigation Assistance (FMA) Program provides funds to assist States and communities to implement measures that reduce or eliminate the long-term risk of flood damage to buildings, manufactured homes, and other structures insured under the National Flood Insurance Program; the Severe Repetitive Loss (SRL) program provides funding to mitigate SRL structures insured under the NFIP to reduce or eliminate the long-term risk of flood damage; and the Repetitive Flood Claims (RFC) grant program provides similar direct assistance to reduce flood damages to insured properties in communities that don't have the capacity to undertake mitigation activates. Given that every one dollar spent on mitigation yields a return of four dollars in avoided losses, these programs have helped slow the growth of the program's enormous $18 billion deficit. Furthermore, in its review of H.R. 5114, the Flood Insurance Reform Act of 2010, CBO noted that "[o]ver the next 10 years, some or all of the costs of the mitigation program may be offset by lower claim payments, depending on the effectiveness of the mitigation efforts." [15]

[15] Congressional Budget Office. Review of H.R. 5114, Flood Insurance Reform Act of 2010. May 17, 2010.

Yet as effective as these programs have been, they can be made more effective and efficient by consolidating the RFC and SRL Grant Programs into the Flood Mitigation Assistance Program as subsets. Doing so would allow the SRL program to reach its full potential, by reducing the burden that SRL properties have on the NFIP, and improving participation in RFC grant program by allowing FEMA or States to work directly with property owners if communities decline to participate.

This solution does not change the net authorization levels for the combined programs, funding for which comes from the transfer of funds from the National Flood Insurance Fund rather than the general treasury. It would, however, reduce bureaucracy and cost and allow FEMA to continue to help communities and property owners reduce flood damage and claims to the NFIP. These cost savings would reduce the program's burden to taxpayers, safeguard communities, help restore the fiscal soundness of the NFIP, and better manage our Nation's floodplains. We urge the Committee to consider this important fix as you begin to draft an NFIP bill.

**FEMA Should Consider Reinsurance To Ensure Risk and Protect Taxpayers**

We were pleased to see that the House included in its bill authority for FEMA to purchase private reinsurance. This is one of the few means available to FEMA to reduce the risk on Federal taxpayers and move the program to safe and sound financial practices. Like a "real" insurance company, the NFIP would retain some risk and buy protection in the private market for catastrophic exposures. This is a prudent step and one we hope the Senate will emulate.

**Conclusion: A New Approach to the Nation's Flooding Problems**

As we begin to assess the damage from some of the most severe flooding since 1927, it is critical that Congress not miss this opportunity to substantially reform the NFIP to better protect people, property and the environment. We urge the Committee to pass a strong, comprehensive reform bill that improves flood risk mapping, ensures risk-based rates and incentivizes mitigation by individuals and communities. Reforming the NFIP can lead to less development and redevelopment in some of the most high risk sensitive areas, better land-use planning, and significant savings for U.S. taxpayers.

---

## PREPARED STATEMENT OF BARRY RUTENBERG

FIRST VICE CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS

JUNE 23, 2011

**Introduction**

Chairman Johnson, Ranking Member Shelby, and Members of the Senate Committee on Banking, I am pleased to appear before you today on behalf of the 160,000 members of the National Association of Home Builders (NAHB) to share our views concerning efforts to reform the National Flood Insurance Program (NFIP). We appreciate the invitation to appear before the Committee on this important issue. My name is Barry Rutenberg and I am the First Vice Chairman of the Board for NAHB and a home builder from Gainesville, Florida.

NAHB commends the Committee for addressing reform of the NFIP program. As we have seen this year, floods can devastate every part of the country—even areas we would never think of, and for this reason, NAHB wants to be very clear that it strongly supports a long-term program reauthorization. We believe a 5-year term is the only way to provide a steady foundation on which to build program revisions and ensure the NFIP is efficient and effective in protecting flood-prone properties. As you know, for the last several years, the NFIP has had to undergo a series of short-term extensions that have created a high level of uncertainty in the program and caused severe problems for our Nation's already troubled housing markets. During these uncertain times, many home buyers faced delayed or canceled closings due to the inability to obtain NFIP insurance for a mortgage. In other instances, builders themselves were forced to stop or delay construction on a new home due to the lack of flood insurance approval, adding unneeded delay and job loss. NAHB believes a long-term extension will ensure the Nation's real estate markets operate smoothly and without delay. We therefore commend the Committee for making this issue a priority.

**Background**

The Federal Emergency Management Agency's (FEMA) National Flood Insurance Program (NFIP) plays a critical role in directing the use of flood-prone areas and managing the risk of flooding for residential properties. The availability and affordability of flood insurance gives local governments the ability to plan and zone their entire communities including floodplains. In addition, if a local government deems an area fit for residential building, flood insurance allows home buyers and homeowners the opportunity to live in a home of their choice in a location of their choice, even when the home lies in or near a floodplain. The home building industry depends upon the NFIP to be annually predictable, universally available, and fiscally viable. A strong, viable national flood insurance program enables the members of the housing industry to continue to provide safe, decent, and affordable housing to consumers.

The NFIP provides flood insurance to over 5 million policyholders, enabling homeowners to protect their properties and investments against flood losses. Further, the NFIP creates a strong partnership between State and local governments by requiring them to enact and enforce floodplain management measures, including building requirements that are designed to ensure occupant safety and reduce future flood damage. This partnership, which depends upon the availability of comprehensive, up-to-date flood maps and a financially stable Federal component, allows local communities to direct development where it best suits the needs of their constituents and consumers. This arrangement has, in large part, worked well. Unfortunately, the losses suffered in the 2004 and 2005 hurricane seasons, including the devastation brought about by Hurricanes Katrina, Rita, and Wilma, have severely taxed and threatened the solvency of the NFIP.

According to FEMA, between the NFIP's inception in 1968 through 2004, a total of $15 billion has been needed to cover more than 1.3 million losses. The 2004 hurricane season required close to $2 billion in NFIP coverage, and the 2005 hurricane season resulted in payments totaling over $13.5 billion. Combined claims for these 2 years exceeded the total amount paid during the previous 37-year existence of the NFIP program. While these losses are severe, they are clearly unprecedented in the history of this important program, as losses since that time have dropped significantly (*e.g.,* $612 million in 2007 and $773 million in 2009). Thus, in our opinion, the losses of 2004 and 2005 are not a reflection of a fundamentally broken program. Nevertheless, NAHB recognizes the need to ensure the long-term financial stability of the NFIP and looks forward to working with this Committee to consider and implement needed reforms, including the possibility of privatizing the NFIP.

While NAHB supports reform of the NFIP to ensure its financial stability, it is absolutely critical that Congress approach this reauthorization with care. The NFIP is not simply about flood insurance premiums and payouts. Rather, it is a comprehensive program that guides future development and mitigates against future loss. NAHB believes a financially stable NFIP is in all of our interests, and the steps that Congress takes to ensure financial stability have the potential to greatly impact housing affordability and the ability of local communities to exercise control over their growth and development options; thus any such steps must be carefully designed and implemented to minimize these real impacts.

**NAHB Supports Thoughtful NFIP Reforms**

The unprecedented losses suffered in 2004 and 2005 have severely taxed and threatened the solvency of the NFIP. While these events have been tragic, sobering, and have exposed shortcomings in the NFIP, any resulting reforms must not be an overreaction to unusual circumstances. Instead, reform should take the form of thoughtful, deliberative, and reasoned solutions. A key step in this process is to take stock of where we are today, what has worked, and what has not.

An important part of the reform process is determining what area or areas of the NFIP are in actual need of reform. In the past, a key tool in the NFIP's implementation, the Flood Insurance Rate Maps (FIRMs), have been recognized by Congress to be inaccurate and out-of-date. Through the strong leadership of both Chambers, FEMA is completing its map modernization effort to digitize, update, and modernize the Nation's aging flood maps. While FEMA was successful in digitizing most of the FIRMs, not all are based on updated hydrologic data and a recent National Academy of Sciences report faulted some of the maps because of a lack of reliable topographical data. As a result of these data deficiencies, there are large discrepancies between what was mapped as the 1-percent annual chance of flood (100-year floodplain) decades ago and what areas may be reflected as falling within the 1-percent annual chance of flood on the newer maps, and what the actual 1-percent annual chance of flood is today. While FEMA is currently addressing this oversight through its RISKMAP program, NAHB believes that continued Congressional oversight is necessary. Ensuring the scientific validity of the maps, as well as ensuring that they reflect the true risks to property is an extremely important step for all who rely on NFIP. It is for this reason that NAHB supports the establishment of a Technical Mapping Advisory Council, as proposed in the House bill H.R 1309. We are hopeful that if such a council is approved, it would also result in further collaboration and coordination among the agencies and the private sector, thus leading to regular dialog to help ensure that the NFIP is working as intended.

Fixing the maps, however, is merely the first step. In an attempt to improve both the solvency of the program and its attractiveness to potential policyholders, NAHB supports a number of reforms designed to allow FEMA, through the NFIP, to better adapt to changes to risk, inflation, and the marketplace. Increasing coverage limits to better reflect replacement costs, for example, would provide more assurances that legitimate losses will be covered and improve program solvency by generating increased premiums. Similarly, the creation of a more expansive "deluxe" flood insurance option, or a menu of insurance options from which policyholders could pick and choose, could provide additional homeowner benefits while aiding program solvency. Finally, increasing the minimum deductible for paid claims would provide a strong incentive for homeowners to mitigate and protect their homes, thereby reducing potential future losses to the program.

The NFIP and its implementing provisions were not created solely to alleviate risk and generate premiums. They were created to balance the needs of growing communities with the need for reasonable protection of life and property. Part and parcel of this is the need for regulatory certainty and expedient decision making. First, the NFIP must continue to allow State and local governments, not the Federal Government, to dictate local land-use policies and make decisions on how private property may be used. While officials at all levels of government must work together so that lives, homes, schools, businesses and public infrastructure are protected from the damages and costs incurred by flooding, the local communities must provide the first line of defense in terms of land-use policies and practices. It is clear that the NFIP was specifically designed to allow this to occur, as the availability of flood insurance is predicated on the involvement of the community and relies on the breadth of activities that local governments can (and do) take to protect their citizens and properties from flood damage.

Additionally, FEMA must better coordinate its activities with those of other Federal agencies who have oversight over other Federal programs. For example, FEMA recently began requiring certain property owners to demonstrate compliance with the Endangered Species Act (ESA) prior to FEMA issuing them a Conditional Letter of Map Revision.[1] To do so, FEMA must engage the U.S. Fish and Wildlife Service or the National Marine Fisheries Service in an extensive consultation to determine the potential impacts on the endangered species in question and to develop any steps that could be taken to mitigate any adverse effects. FEMA, however, has claimed it does not have to resources to conduct the review and has deflected its responsibilities to the landowner. Not only does this cause confusion, but FEMA's dereliction of duties places landowners in a no-win situation, creating project delays, increased construction costs, and a decreases in housing affordability. As NAHB does not believe that the NFIP is a proper trigger for the ESA, we are hopeful that any legislation will clarify that such consultations are unnecessary. Likewise, we are hopeful that FEMA will work to improve collaboration and cooperation with the other Federal, State, and local entities as this program continues to evolve (*see,* Appendix).

Similarly, NAHB believes FEMA could do a better job of coordinating and overseeing local efforts to implement building codes as part of a community's floodplain management program. In an effort to address this shortcoming, past NFIP bills have asked for a report on the inclusion of building codes in floodplain management criteria. While NAHB supports efforts to allow FEMA to conduct a study on the efficacy, economic and regulatory impacts, and effectiveness of including national model building codes, NAHB believes it would be beneficial to evaluate the effectiveness of allowing States to continue to use the national model codes—specifically, International Building Code and International Residential Code—with State-specific amendments, as currently allowed.

Past language has been unclear about exclusions and would allow State-prescribed or other privately developed building codes and standards to be considered in the study. This is problematic because over the last 5 years, State and local governments have begun adopting various "green" codes and protocols for use as mandatory building standards within their respective jurisdictions. In addition to the fact that these codes may not adequately consider the unique geographic needs for building in zones with the potential for high-impact natural disaster risks, these codes and standards generally exist outside of the scope of the national model code development bodies. As such, they can be prohibitively expensive and may not pro-

[1] Procedure Memorandum No. 64—*http://www.fema.gov/library/viewRecord.do?id=4312* (*see,* Appendix).

vide all stakeholders an opportunity to equally participate in the codes' development.

NAHB supports allowing FEMA to investigate the costs and benefits of using the national model codes with respect to floodplain management and enforcement in areas with high-impact weather risks. However, NAHB recommends that the study language be modified to focus only on the national model codes that have provisions to address floodplain management criteria—*i.e.*, the International Building Code and the International Residential Code—and not to consider "green" codes, even "green" codes that have been developed in accordance with the model codes development process, as such codes are not designed to accommodate affordability criteria, which is critical in any cost-benefit analysis.

More importantly, NAHB believes that FEMA must maintain the flexibility for State and local governments to adopt innovative ways to address building needs that cannot be achieved through a nationally applied or privately developed code. As such, NAHB recommends that any study on the cost-benefit impacts of adopting national model building codes must include codified safeguards preserving the rights of State and local governments to amend the model building codes to meet specific local needs. Lastly, FEMA must ensure that any study on the impacts of building codes in NFIP be conducted with explicit prohibition against the development, implementation, or enforcement of national model codes by FEMA itself.

**NAHB Is Concerned With Potential Negative Reforms**

As Congress considers strategies to bolster the financial stability of the NFIP, NAHB cautions against those reforms that have far-reaching and unintended consequences, including reforms that decrease housing affordability and the ability of communities to meet current and future growth needs. Chief among these concerns are changes that would require more homeowners to purchase insurance and expand the Special Flood Hazard Area (SFHA), or expand the current Federal minimum residential design, construction, and modification standards.

NAHB believes that modifying the numbers, location, or types of structures required to be covered by flood insurance may play an important part in ensuring the NFIP's continued financial stability, but any such decision must be taken with extreme care. Two options have been widely considered in recent years. The first would require the mandatory purchase of flood insurance for structures located behind flood control structures, such as levees or dams. The second would mandate that all structures within the 1-percent annual chance of flood obtain flood insurance regardless of whether or not they currently hold a mortgage serviced by a federally licensed or insured carrier. While both of these strategies would increase the number of residences participating in the NFIP, buttressing the program against greater losses, they are not as simple as they seem. At a minimum, NAHB believes that before any reforms are enacted FEMA should first demonstrate that the resulting impacts on property owners, local communities, and local land use are more than offset by the increased premiums generated and the hazard mitigation steps taken. Only after such documentation is provided, documentation that includes the regulatory, financial, and economic impact of reform efforts, can Congress, FEMA, stakeholders, and the general public fully understand whether or not such actions are appropriate.

One important component of the NFIP is the ability of communities, with the assistance of the Federal Government, to design, install, and maintain flood protection structures for the purpose of reducing risk. In most instances, residential structures located behind dams or levees that provide protection to the 1-percent-annual-chance flood level are not required to purchase flood insurance. This is a planned trade off. In exchange for constructing adequate flood controls, structures located behind those controls are removed from the 100-year floodplain or SFHA on the relevant FIRM. Accordingly, any reforms that contemplate bringing these same residences back under a mandatory purchase requirement raise very real and powerful equity and fairness issues. Should Congress or FEMA produce adequate documentation indicating that the benefits of mandating flood insurance purchase for residences behind flood control structures outweigh the costs to homeowners, NAHB would support these residences being charged premiums at a reduced rate to reflect their reduced risk. A great deal of time and taxpayer money was invested to provide additional flood protection to these residences, and it is only fair that homeowners in these areas, if required to purchase insurance, be recognized for their communities' efforts. In addition, some localities charge a levee fee on property taxes to residents for operation and maintenance of the levee, charging for flood insurance is an additional burden.

While changes to the NFIP's mandatory flood insurance purchase requirements present one set of issues, a programmatic change of the SFHA presents an entirely different and overwhelming set of concerns. Changing the SFHA from a 100-year standard (1-percent-annual chance flood) to a higher level (*i.e.,* 500-year standard as described in previous bills) would not only require more homeowners to purchase flood insurance, but would also impose mandatory construction requirements on a completely new set of structures. Furthermore, those homeowners who had been in compliance with the 100-year standard will suddenly find themselves below the design flood elevation for the increased level. Although these structures may be grandfathered and avoid higher premiums as a result of their noncompliant status, this ends when the structure is sold or substantially improved. Placing these homes in this category impacts their resale value in a very real way, as any new buyer may be faced with substantially higher premiums or retrofit and compliance costs.

Any revision of the SHFA standard would not only affect homeowners, but also home builders, local communities, and FEMA. An expanded floodplain means an expanded number of activities taking place in the floodplain, and a corresponding increase in the overhead needed to manage and coordinate these activities. A larger regulated floodplain would likely result in an increased number of flood map amendments and revisions, placing additional burdens on Federal resources to make these revisions and amendments in a timely fashion. Residents located in newly designated SFHAs would need to be notified through systematic outreach efforts. Communities would likely need to modify their floodplain ordinances and policies to reflect the new SFHA. In short, the entire infrastructure of flood management and mitigation practice and procedures that is currently institutionalized around the 1-percent-annual chance flood standard would need to change, all at a time when FEMA has admitted its lack of resources to provide current services.

Furthermore, there is little convincing data to demonstrate that such a change is necessary or prudent. Indeed, even specially convened policy forums have failed to reach consensus on the issue. As a result, NAHB strongly cautions against making such sweeping changes to the NFIP and supports the House bill (H.R 1309), which maintains the 100-year level for both maps and the SFHAs.

While requiring mandatory flood insurance purchase is one option, another option that has been considered is to require structures to meet Federal residential design, construction, and modification requirements. NAHB is strongly opposed to expanding such requirements to any new classes of structures, including those found behind flood protection structures and those affected by any programmatic change to the SFHA. Any such requirements would substantially increase the cost of home construction and severely impact housing affordability. For example, elevating structures could add $60,000 to $210,000 to the cost of a home.[2] It is easy to see the tremendous impact that such reforms would have not only on Nation's home builders, but also on the Nation's home buyers and homeowners. NAHB urges Congress to soften the impact of any programmatic changes to the NFIP by ensuring that construction requirements remain tied to the 1-percent-annual chance flood standard.

Finally, past bills would phase-in actuarial rates for nonresidential properties and nonprimary residences. NAHB's primary concern is that flood insurance remains available and affordable. FEMA reports that 78 percent of policyholders are already paying actuarial (risk-based) premiums;[3] nevertheless, NAHB believes reforms aimed at reducing Federal subsidies for any subset of the remaining properties must ensure that overall affordability is not adversely affected. NAHB looks forward to working with the Committee to strike the proper balance between ensuring the long-term financial viability of the NFIP, and ensuring program affordability and equality for those who rely on this valuable Government insurance program.

Thank you for this opportunity to share the views of the National Association of Home Builders on this important issue. We look forward to working with you and your colleagues as you contemplate changes to the National Flood Insurance Program to ensure that federally backed flood insurance remains available, affordable, and financially stable. We urge you to fully consider NAHB's positions on this issue and how this program enables the home building industry to deliver safe, decent, affordable housing to consumers. I look forward to any questions you or other Members of the Committee may have for me.

[2] Federal Emergency Management Agency, "Homeowner's Guide to Retrofitting", (Dec. 2009) table 3-3—Using the dollar figures in table 3-3 multiplied by a 2,200 square foot median house size (*see,* Appendix).

[3] Federal Emergency Management Agency, "Actuarial Rate Review: In Support of the October 1, 2010, Rate and Rule Changes", (July 2010) p. 22 (*see,* Appendix).

**APPENDIX**

National Association
of Home Builders

**Appendix**

*Resolving Regulatory Confusion - Clarifying the Relationship between the National Flood Insurance Program and the Endangered Species Act*

In recent years, environmental groups have targeted the Federal Emergency Management Agency's (FEMA) National Flood Insurance Program (NFIP) by filing procedural lawsuits under the Endangered Species Act (ESA) that allege that FEMA has failed to comply with the ESA's consultation requirements when administering various facets of the National Flood Insurance Program (NFIP).[1] Importantly, these cases are not necessarily focused on protecting species, but are designed to impede development in certain areas. FEMA, for its part, has tried to fight these ESA lawsuits, but unfortunately, a number of federal courts have ruled with the environmental groups. The courts agree that the NFIP, as currently enacted, is a "discretionary" federal program and thus subject to the ESA's consultation requirements. Contrary to these decisions, NAHB does not believe that Congress envisioned the ESA being applied to FEMA's floodplain program and urges it to revisit and amend this timely and problematic issue.

*Background:*

The Endangered Species Act (ESA) authorizes the federal government to regulate endangered and threatened species and their habitat on private as well as public property. Because the Act's fundamental prohibitions are absolute and driven by biological factors and not — as in other environmental statutes — based on a balancing test that takes into account economic impacts, the ESA is a potent source of federal land use regulation. With the number of endangered and

[1] *E.g.: NationalWildlife Federation v. Furgate,* 10-22300, (S.D. Fl. 2011) (Settlement requiring FEMA to initiate consultation); *Audubon Society of Portland v. Federal Emergency Management Agency*, no. 09-00729 (D. Or. 2010) (settlement requiring FEMA to consult with the FWS over certain activities); *WildEarth Guardians v. Federal Emergency Management Agency,* no. 10- 00863 (D. Az., Complaint filed Aug. 26, 2009); *Florida Key Deer v. Paulison*, 522 F.3d 1133 (11th Cir. 2008) (affirming an injunction prohibiting FEMA from issuing flood insurance for new developments in suitable habitats of listed species); *National Wildlife Federation v Federal Emergency Management Agency*, 345 F.Supp.2d 1151 (W.D. Wash. 2004) (holding that FEMA was required to engage in ESA consultation with regard to its mapping activities, setting eligibility criteria, and implementing community rating system (CRS); but that FEMA had no duty to formally consult with regard to the effect of sale of flood insurance on salmon).

threatened species protected by the Act rising steadily, the ESA is an increasingly important hurdle for projects across the country.

Since the early 2000's, special interests groups have worked to broaden the application of the ESA to include essentially any activity that alters the landscape. While earlier attempts mainly focused on the ESA's application to portions of the Clean Water Act (CWA) and larger projects, over time a new attack has been launched concerning the applicability of the ESA to the NFIP. In short, the reasoning articulated in these lawsuits is premised on a simplistic and shrewd "but for" hypothesis; that is, were it not for the NFIP, residential development or development of any kind could not occur in many areas of the country. Therefore, these groups argue that in geographic areas that have been designated as "critical habitat" by the U.S. Fish and Wildlife Service (FWS) or NOAA Fisheries (hereafter referred to as the Service), FEMA must "consult" with the Service over its administration of the NFIP.

The position that NFIP must be subject to the ESA in order to protect endangered species is problematic in that it is overly broad and ignores the fact that the ESA, independent of NFIP program, already prohibits the "taking" of endangered species. Likewise, it fails to adhere to the statutory limits of the ESA, which only require consultation for "discretionary" actions.

According to the special interests, ESA consultation should occur in any area that has been designated as critical habitat. Presently, there are over 1,200 species listed as "endangered" under the ESA. To date, the Service has only designated critical habitat for half of these species (603), but that has still resulted in the designation of tens of millions of acres. Moreover, the critical habitats are concentrated primarily in a handful of states, including Florida – a state that has a significant portion of its land area located within the floodplain. The economic burden of critical habitat designation is disproportionately borne at the county level. Since most counties push for promoting economic development and population growth, the burden of ESA permitting compliance typically falls on the residential construction industry in comparison to other industries. The cost of ESA compliance ultimately results in project delays, increases the cost of construction and adversely impacts affordability. Requiring consultation within the NFIP will clearly exacerbate these difficulties.

Equally problematic are the claims that additional protections are necessary to conserve species. The ESA's take prohibition expressly disallows any action (public or private) that results in the death or injury of a federally-protected species.[2] Furthermore, the ESA's consultation requirements already apply to all publicly funded projects and any private project that necessitates a "discretionary" federal permit or approval.[3] For residential construction activities, a typical "trigger" for the ESA consultation is a CWA Section 404 wetlands permit issued by the U.S. Army Corps of Engineers. Another common ESA trigger is the CWA's Section 402 construction general permit issued by the U.S. Environmental Protection Agency (EPA). According to the Service, over 35,000 consultations were conducted during 2009, the most recent year for which data is available.[4] Requiring FEMA to comply with the ESA for all aspects of the NFIP program is clearly duplicative and unnecessary.

Further, because the current legal and regulatory threshold for determining whether or not a specific federal action is subject to the ESA's consultation requirement is entirely dependent on whether the specific federal action is discretionary (subject to ESA consultation requirements) or non-discretionary (not subject to ESA's consultation requirements), an examination of where the action falls is critical to determining any subsequent consultation obligations.

*One Example:*

In response to the ESA court ruling, last August FEMA issued Procedure Memorandum No. 64 (PM 64) to all FEMA Regional Division Directors. PM 64 established new procedures for how FEMA will demonstrate compliance with the ESA.[5] FEMA's memorandum requires all landowners seeking Conditional Letters of Map Revision (CLOMR) or Conditional Letter of Map Revision based on Fill (CLOMR-Fs) to demonstrate compliance with the ESA prior to seeking letters from FEMA. FEMA issued PM 64 not as a typical federal rulemaking subject to public notice and comment, but rather as an agency directive that became effective on October 1, 2010.

[2] 16 U.S.C. § 1538.
[3] 50 C.F.R. § 402.03.
[4] U.S. Fish and Wildlife Service. Consultation with Federal Agencies: Section 7 of the Endangered Species Act. Questions and Answers. November 2010. FWS website last visited on March 4, 20111. http;//www.fws.gov/endangered/
[5] U.S. Department of Homeland Security, Federal Emergency Management Agency (FEMA). Procedure Memorandum 64 – Compliance with the Endangered Species Act (ESA) for Letters of Map Change. August 18, 2010. FEMA's website last visited on March 7, 2011. http://www.fema.gov/library/viewRecord.do?id=4312

Historically, landowners seeking CLOMR or CLOMR-F letters from FEMA were not required to provide written documentation of ESA compliance prior to seeking a revision to a FIRM. PM 64 has the potential to add significant confusion, delays, and expense for landowners. Under the ESA's consultation regulations, the Service has a minimum of 90 days to complete a consultation. However, the Service can extend that timeframe by an additional 60 days if the applicant agrees in writing. In practice, consultations performed by the Service routinely take six months or longer. Another method for demonstrating ESA compliance highlighted in PM 64 is the use of the ESA's Incidental Take Permits (ITP).[6] The ITPs are even more problematic than the consultation process because unlike Section 7 Consultations, the ITP process contains no specified deadlines, requires separate public notice and comment before issuance, and takes the Service typically two years to complete.[7]

Taken at face value, FEMA's memorandum has the potential to add significant confusion, expense and delay for landowners who are seeking simple revisions to federal flood plain maps to complete projects and secure affordable flood insurance. While it is possible under FEMA's guidance for landowners whose projects have obtained proof of ESA compliance through another federal permitting process, questions remain about how FEMA's guidance will be implemented.

*A Possible Solution:*

In a landmark U.S. Supreme Court ruling, *Nat'l Ass'n of Home Builders v. Defenders of Wildlife,*[8] (hereinafter *NAHB v. Defenders)* the U.S. Supreme Court held that the ESA's consultation obligation is triggered *only* for federal *discretionary* actions, meaning an action a federal agency *may* take (e.g., providing federal funding). Moreover, the Court held that the ESA's consultation provisions do *not* apply to federal actions that are non-discretionary, meaning an action a federal agency *must* take pursuant to federal law. In *NAHB v. Defenders,* environmental groups argued that the U.S. (EPA) delegation of the CWA § 402 NPDES permitting authority to the State of Arizona was subject to the ESA's consultation requirements.

[6] U.S. Department of Homeland Security, Federal Emergency Management Agency (FEMA). Procedure Memorandum 64 – Compliance with the Endangered Species Act (ESA) for Letters of Map Change. August 18, 2010. Page 3 of FEMA's memo. FEMA's website last visited on March 7, 2011. http://www.fema.gov/library/viewRecord.do?id=4312
[7] 50 C.F.R. § 17.22(d)(2)(ii).
[8] 551US 644 (2007).

The Supreme Court disagreed; finding the EPA's decision to delegate the CWA § 402 program was not a discretionary action. As the Court explained, once EPA had determined the State of Arizona met the criteria set forth under the statute; EPA had no discretion in determining whether or not to delegate the CWA program to the State of Arizona.[9] As the Court noted "[w]hile EPA may exercise some judgment in determining whether a state has demonstrated that it has the authority to carry out § 402(b)'s enumerated statutory criteria, the statute clearly does not grant it [EPA] the discretion to add another entirely separate prerequisite to that list."[10]

NAHB believes that *NAHB v. Defenders* provides the members of this Subcommittee with the perfect context on how to ensure the NFIP program once reauthorized by Congress, is not subject to ESA's consultation provisions. EPA itself has tried to leverage *NAHB v. Defenders* to prevent the ESA from obstructing its ability to delegate permitting authority under the CWA section 404 (as opposed to section 402) program. EPA's Assistant Administrator for Water, Mr. Peter S. Silva, sent a letter to the Environmental Council of the States (ECOS) in December 2010, clarifying EPA's position that state delegation of the CWA Section 404 wetlands program is not subject to the ESA Consultation provisions.[11] Unfortunately, FEMA cannot similarly utilize *NAHB v. Defenders* because federal courts have already ruled that the NFIP program is a discretionary federal program and thus subject to the ESA's requirements. NAHB, therefore, urges this Subcommittee to examine ways to reauthorize the NFIP and specifically state that it is a non-discretionary program. This will ensure that the NFIP is subject to, and benefits from, the flexibility afforded by *NAHB v. Defenders*.

NAHB believes that the NFIP was not, and should not, be designed as an environmental protection statute. Rather, the purpose of the NFIP is to protect human lives and property. As a result, FEMA should not be saddled with demonstrating compliance with the ESA in accomplishing its mission. Therefore, in light of this and the arguments put forth above, NAHB strongly urges Congress to exempt the NFIP and FEMA's administration of it from the ESA's consultation requirements.

---

[9] 33 U.S.C. § 1342(b).
[10] *NAHB*, 551 U.S. at 671.
[11] U.S. Environmental Protection Agency. Letter from EPA Assistant Administrator, Office of Water to Environmental Council of the States (ECOS) on ESA's Consultation requirements under CWA §404 Wetlands Program. December 27, 2010. ECOS's website last visited on March 4, 2011. http://www.ecos.org/files/4324_file_Silva_Reply_on_ESA_Consultation.pdf

U.S. Department of Homeland Security
500 C Street SW
Washington, DC 20472

FEMA

August 18, 2010

**MEMORANDUM FOR:** Regional Division Directors
Regions I - X

**FROM:** Doug Bellomo, P.E.
Director, Risk Analysis Division

**SUBJECT:** Procedure Memorandum 64 – Compliance with the Endangered Species Act (ESA) for Letters of Map Change

**EFFECTIVE DATE:** All Conditional Letter of Map Change submittals received as of October 1, 2010

**Background:** The purpose of the ESA is to conserve threatened and endangered species and the ecosystems upon which they depend. Congress passed the ESA in 1973 with recognition that the natural heritage of the United States was of "esthetic, ecological, educational, recreational, and scientific value to our Nation and its people." Congress understood that, without protection, many of our nation's living resources would become extinct. Species at risk of extinction are considered endangered, whereas species that are likely to become endangered in the foreseeable future are considered threatened. At present approximately 1,900 species are listed as threatened or endangered under the ESA. The U.S. Department of Interior's Fish and Wildlife Service and the U.S. Department of Commerce's National Marine Fisheries Service (collectively known as "the Services") share responsibility for implementing the ESA.

Section 7 of the ESA requires each federal agency to insure that any action it authorizes, funds, or carries out is not likely to jeopardize the continued existence of any listed species or result in the destruction of adverse modification of designated critical habitat[1].

Section 9 of the ESA prohibits anyone from "taking" or "harming" endangered wildlife and similar prohibitions are generally extended through regulations for threatened wildlife. If an action might harm[2] a threatened or endangered species, an incidental take authorization is required from the Services under Sections 7 or 10 of the ESA.

**Issue:** Conditional Letters of Map Change (LOMCs) are issued before a physical action occurs in the floodplain and are FEMA's comments as to whether the proposed project would meet minimum National Flood Insurance Program (NFIP) requirements and how the proposed changes would impact the NFIP maps. Because Conditional Letters of Map Revision based-on Fill (CLOMR-Fs) and Conditional Letters

---

[1] In accordance with Section 4 of the ESA, critical habitat includes specific areas essential to conservation of a species and those areas which may require special management considerations or protection.

[2] Harm can arise from "significant habitat modification or degradation where it actually kills or injures wildlife by significantly impairing essential behavioral patterns, including breeding, feeding or sheltering" [50 CFR Part 17.3].

of Map Revision (CLOMRs) are submitted to FEMA prior to construction, there is an opportunity to identify if threatened and endangered species may be affected by the potential project. If potential adverse impacts could occur, then the Services may require changes to the proposed activity and/or mitigation.

For LOMC requests involving floodplain activities that have already occurred, private individuals and local and state jurisdictions are required to comply with the ESA independently of FEMA's process. These requests do not provide the same opportunity as Conditional LOMCs for FEMA to comment on the project because map changes are issued only after the physical action has been undertaken.

The following table provides a general summary of FEMA's ESA requirements.

| Request | ESA-related Action | ESA Requirement Related to FEMA Process |
|---|---|---|
| *Conditional LOMC Requests* | | |
| CLOMA | No physical modification to floodplain is proposed. | ESA compliance is required independently of FEMA's process. The community needs to ensure that permits are obtained per requirement under Section 60.3(a)(2) of FEMA's regulations. |
| CLOMR-F | Proposed placement of fill in the floodplain. | ESA compliance must be documented to FEMA prior to issuance of CLOMR-F. FEMA must receive confirmation of ESA compliance from the Services. |
| CLOMR | Proposed modifications of floodplains, floodways, or flood elevations based on physical and/or structural changes. | ESA compliance must be documented to FEMA prior to issuance of CLOMR. FEMA must receive confirmation of ESA compliance from the Services. |
| *LOMC Requests* | | |
| LOMA | No physical modification to floodplain has occurred. | ESA compliance is required independently of FEMA's process. The community needs to ensure that permits are obtained per requirement under Section 60.3(a)(2) of FEMA's regulations. |
| LOMR-F | Placement of fill in floodplain has occurred. | ESA compliance is required independently of FEMA's process. The community needs to ensure that permits are obtained per requirement under Section 60.3(a)(2) of FEMA's regulations. |
| LOMR | Modifications of floodplains, floodways, or flood elevations have occurred based on physical and/or structural changes. | ESA compliance is required independently of FEMA's process. The community needs to ensure that permits are obtained per requirement under Section 60.3(a)(2) of FEMA's regulations. |

**Action Taken:** For CLOMR-F and CLOMR applications, the submittal will be reviewed based on:

- Required data elements cited in the NFIP regulations
- Required data elements cited in the MT-1 and MT-2 Application/Certification Form instructions
- Demonstrated compliance with the ESA

The CLOMR-F or CLOMR request will be processed by FEMA only after FEMA receives documentation from the requestor that demonstrates compliance with the ESA. The requestor must demonstrate ESA compliance by submitting to FEMA either an Incidental Take Permit, Incidental Take Statement, "not likely to adversely affect" determination from the Services or an official letter from the Services concurring that the project has "No Effect" on listed species or critical habitat. If the project is likely to cause jeopardy to listed species or adverse modification of critical habitat, then FEMA shall deny the Conditional LOMC request. This Procedure Memorandum will not change the review process for Conditional Letters of Map Amendment (CLOMA), Letter of Map Amendment (LOMA), Letter of Map Revision based-on Fill (LOMR-F), or Letter of Map Revision (LOMR) applications. In addition, FEMA's Cooperating Technical Partners will be required to comply with this Procedure Memorandum.

**Attachment:**
Guidance for Compliance with the Endangered Species Act for Conditional Letters of Map Change

Cc: See Distribution List

**Distribution List** (electronic distribution only):

Office of Chief Counsel

Risk Analysis Division

Risk Reduction Division

Environmental and Historic Preservation Unit

Regional Mitigation Divisions

Regional Environmental Officers

Legislative Affairs Division

Production and Technical Services Contractors

Customer and Data Services Contractor

Cooperating Technical Partners

# Guidance for Compliance with the Endangered Species Act for Conditional Letters of Map Change

This document supplements the Federal Emergency Management Agency's (FEMA's) Procedure Memorandum No. 64. It highlights additional resources and frequently asked questions to help guide Conditional Letter of Map Revision (CLOMR) and Conditional Letter of Map Revision based on Fill (CLOMR-F) applicants in the Endangered Species Act (ESA) compliance process. The following sections identify helpful web resources, while the final section includes responses to frequently asked questions.

## NATIONAL FLOOD INSURANCE PROGRAM AND LETTERS OF MAP CHANGE

Additional information about the National Flood Insurance Program (NFIP) and Letters of Map Change (LOMC) is available from FEMA.

NFIP: http://www.fema.gov/hazard/flood/info.shtm
LOMCs: http://www.fema.gov/hazard/map/lomc.shtm

## ESA OF 1973

Additional information about the ESA and Endangered Species Programs is available from the National Marine Fisheries Service (NMFS) and the U.S. Fish and Wildlife Service (USFWS). These two agencies, collectively known as "the Services," share responsibility for implementing the ESA and assisting all individuals (public and private) in the ESA compliance process.

NMFS: http://www.nmfs.noaa.gov/pr/laws/esa/
USFWS: http://www.fws.gov/endangered/whatwedo.html

## GETTING STARTED WITH ESA COMPLIANCE AND WHO TO CONTACT

CLOMR and CLOMR-F applicants are responsible for demonstrating to FEMA that ESA compliance has been achieved prior to FEMA's review of a CLOMR or CLOMR-F application. The applicant may begin by contacting a local Service office, State wildlife agency office, or independent biologist to identify whether threatened or endangered species exist on the subject property and whether the project associated with the CLOMR or CLOMR-F request would adversely affect the species. These entities are also available to discuss questions pertaining to listed species and ESA compliance.

NMFS Regional Offices: http://www.nmfs.noaa.gov/regional.htm
USFWS Office Directory: http://www.fws.gov/offices/

## DEMONSTRATING COMPLIANCE WITH THE ESA

If species may be affected adversely by the project, the applicant (as a non-Federal entity) would be required to obtain compliance through the Section 10 process. This process includes applying for an Incidental Take Permit (ITP) and preparing a habitat conservation plan (HCP). Additional information about Section 10 requirements and the permit application process is available from NMFS and USFWS.

ITPs and NMFS: http://www.nmfs.noaa.gov/pr/permits/faq_esapermits.htm
ITPs and USFWS: http://www.fws.gov/endangered/hcp/hcpplan.html
HCPs and NMFS: http://www.nwr.noaa.gov/Salmon-Habitat/Habitat-Conservation-Plans/Index.cfm
HCPs and USFWS: http://www.fws.gov/endangered/hcp/index.html
NMFS Permit applications: http://www.nmfs.noaa.gov/pr/permits/esa_permits.htm
USFWS Permit application: http://www.fws.gov/forms/3-200-56.pdf

To demonstrate to FEMA that ESA compliance has been achieved, the requestor must provide an ITP, an Incidental Take Statement, a "not likely to adversely affect" determination from the Services, or an official letter from the Services concurring that the project has "No Effect" on proposed or listed species or designated critical habitat. If the project is likely to cause jeopardy of a species' continued existence or adverse modification to designated critical habitat, then FEMA shall refuse to review the CLOMR or CLOMR-F request without prior project approval from the Services. If a Federal entity is involved in a proposal or project for which a CLOMR or CLOMR-F has been requested, then the applicant may coordinate with that agency to demonstrate to FEMA that Section 7 ESA compliance has been achieved through that other Federal agency.

## Frequently Asked Questions

***For which map change applications does FEMA require demonstrated ESA compliance?***
FEMA requires applicants to demonstrate compliance for CLOMRs and CLOMR-Fs only.

***Why is ESA compliance required before FEMA can review my CLOMR or CLOMR-F application?***
All individuals in this country (private and public) have a legal responsibility to comply with the ESA. FEMA recognizes that potential projects for which a CLOMR or CLOMR-F has been requested may affect threatened and endangered species. As a result, FEMA requires documentation to show that potential projects comply with the ESA before a CLOMR or CLOMR-F application can be reviewed.

***Why does FEMA not require demonstration of ESA compliance for other LOMC applications?***
Many LOMC requests involve floodplain activities that have occurred already. As a result, FEMA does not have the opportunity to comment on these projects in terms of ESA compliance prior to the physical changes taking place. Private individuals and local and state jurisdictions are required to comply with the ESA independently of FEMA's process.

***What will FEMA require from CLOMR and CLOMR-F applicants to demonstrate ESA compliance?***
As part of the CLOMR or CLOMR-F application, the requestor must provide an ITP, an Incidental Take Statement, a "not likely to adversely affect" determination from the Services, or an official letter from the Services concurring that the project has "No Effect" on proposed or listed species or designated critical habitat.

***How much time will be required to achieve ESA Compliance?***
The timeframe needed to achieve ESA compliance will depend entirely on the complexity of the project, the extent to which species may be affected by the project, the quality of biological analyses conducted by the applicant, and the review process as determined by the Services. Therefore, we recommend that LOMC applicants coordinate with the Services as soon as possible within the project development process.

***Who is available to answer my questions about ESA compliance?***
NMFS and the USFWS both have staff available around the country to answer questions about threatened and endangered species and ESA compliance. Refer to the *NMFS Regional Offices* and *USFWS Office Directory* links on Page 1 of this guidance document to identify the nearest available Service office. FEMA does not have staff available to assist with this process.

***How do I determine if there are threatened or endangered species or critical habitat in my project area?***
The applicant may begin by contacting a local Service office, state wildlife agency office, or independent biologist to identify whether threatened or endangered species exist on the subject property and whether the project associated with the CLOMR or CLOMR-F would adversely affect the species.

***Do I need to hire a biologist for this process?***

While hiring a biologist may be unnecessary, doing so may help facilitate the process. Biologists familiar with subject species and the regulatory process can help adequately complete many of the studies required as part of the Section 10 process and fulfill other Section 10 requirements.

***How are the following ESA-related terms defined?***

"Take" means to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any such conduct and may include habitat modification or degradation.

"Harm" can arise from significant habitat modification or degradation where it actually kills or injures wildlife by significantly impairing essential behavioral patterns, including breeding, feeding or sheltering.

"Section 7" requires all Federal agencies, in consultation with USFWS or NMFS, to use their authorities to further the purpose of the ESA and to ensure that their actions are not likely to jeopardize the continued existence of listed species or result in destruction or adverse modification of critical habitat.

"Section 10" lays out the guidelines under which a permit may be issued to non-Federal parties to authorize prohibited activities, such as take of endangered or threatened species.

"ITP" or incidental take permit is a permit issued under section 10(a)(1)(B) of the ESA to a non-Federal party undertaking an otherwise lawful project that might result in the "take" of an endangered or threatened species. Application for an incidental take permit is subject to certain requirements, including preparation by the permit applicant of a HCP.

"HCP" or habitat conservation plan is a legally binding plan that outlines ways of maintaining, enhancing, and protecting a given habitat type needed to protect species. It usually includes measures to minimize impacts and may include provisions for permanently protecting land, restoring habitat, and relocating plants or animals to another area. An HCP is required before an incidental take permit may be issued to non-Federal parties.

Other ESA-related terms not described here may be defined on the following website:
http://www.fws.gov/endangered/pdfs/glossary.pdf

Table 3-3. Approximate Square Foot Costs of Elevating a Home (2009 Dollars)

| Construction Type | Existing Foundation | Retrofit | Cost (per square foot of house footprint) |
|---|---|---|---|
| Frame (for frame house with brick veneer on walls, add 10 percent) | Basement or Crawlspace | Elevate 2 Feet on Continuous Foundation Walls or Open Foundation | $29 |
| | | Elevate 4 Feet on Continuous Foundation Walls or Open Foundation | $32 |
| | | Elevate 8 Feet on Continuous Foundation Walls or Open Foundation | $37 |
| | Slab-on-Grade | Elevate 2 Feet on Continuous Foundation Walls or Open Foundation[1] | $80 |
| | | Elevate 4 Feet on Continuous Foundation Walls or Open Foundation[1] | $83 |
| | | Elevate 8 Feet on Continuous Foundation Walls or Open Foundation[1] | $88 |
| Masonry | Basement or Crawlspace | Elevate 2 Feet on Continuous Foundation Walls or Open Foundation | $60 |
| | | Elevate 4 Feet on Continuous Foundation Walls or Open Foundation | $63 |
| | | Elevate 8 Feet on Continuous Foundation Walls or Open Foundation | $68 |
| | Slab-on-Grade | Elevate 2 Feet on Continuous Foundation Walls or Open Foundation[1] | $88 |
| | | Elevate 4 Feet on Continuous Foundation Walls or Open Foundation[1] | $91 |
| | | Elevate 8 Feet on Continuous Foundation Walls or Open Foundation[1] | $96 |

[1]Price shown is for raising the house with the slab attached.

Exhibit A
Page 1

NATIONAL FLOOD INSURANCE PROGRAM

Effects of Rate Revision on Average Annual Written Premium (plus FPF) per Policyholder*
Based on Projected Distribution of Business and Projected Amounts of Insurance

| | Distribution of Business | Average Annual Premium with October 2010 Rates | Increase over Annual Premium with Current Rates |
|---|---|---|---|
| REGULAR PROGRAM - ACTUARIAL RATES | | | |
| AE | 28.9% | 498.87 | 5.9% |
| A | 1.7% | 816.70 | 5.3% |
| AO, AH, AOB & AHB | 8.1% | 387.76 | 1.1% |
| ZONES AE,A,AO,AH,AOB,AHB | 38.7% | 489.36 | 5.0% |
| POST-81 V,VE | 0.9% | 2,806.86 | 9.2% |
| B,C,X (Standard) | 7.7% | 611.74 | 7.4% |
| PRP | 31.3% | 343.65 | 0.0% |
| TOTAL ZONES B,C,X | 39.0% | 396.52 | 2.1% |
| SUBTOTAL ACTUARIAL | 78.5% | 469.10 | 4.0% |
| REGULAR PROGRAM - SUBSIDIZED RATES | | | |
| Pre-FIRM AE | 16.2% | 1,166.27 | 2.6% |
| Pre-FIRM V,VE | 0.7% | 1,806.75 | 3.4% |
| Pre-FIRM Other | 3.8% | 1,068.81 | 2.6% |
| PRE-FIRM SUBSIDIZED | 20.8% | 1,176.41 | 2.7% |
| 75-81 POST V,VE | 0.1% | 1,468.36 | 9.5% |
| A99 & AR | 0.5% | 895.95 | 9.0% |
| EMERGENCY | 0.0% | 402.20 | 0.0% |
| SUBTOTAL SUBSIDIZED | 21.5% | 1,170.07 | 2.9% |
| TOTAL | 100.0% | 619.79 | 3.6% |

*Computations are based on counting and pricing units insured under Condo Master Policies separately.

** Includes all other Pre FIRM zones, including AO, AH, AOB, AHB, D, AR, and A99.

**Exhibit A.** Effects of Rate Revisions on Written Premium, Page 1

**PREPARED STATEMENT OF TRAVIS B. PLUNKETT**

LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

JUNE 23, 2011

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I appreciate the invitation to appear before you today to discuss how to reform and reauthorize the National Flood Insurance Program (NFIP). My name is Travis Plunkett and I am the Legislative Director of the Consumer Federation of America (CFA). CFA is a nonprofit association of 300 organizations that has sought to advance the consumer interest through research, advocacy, and education since 1968. I am here today because our Insurance Director, J. Robert Hunter, is, unfortunately, not available. Hunter was the Federal Insurance Administrator under Presidents Ford and Carter, where he helped create and run the NFIP in the 1970s. He also served as Texas Insurance Commissioner.

As Hunter has testified before this Committee several times, the NFIP is in very deep trouble.[1] CFA recommends a three-step process to fix long-term, structural flaws in the program that are harming consumers and taxpayers. First, use legislation reported out of the Committee on a bipartisan basis in 2007 as the basis for improving and extending the program for no more than 2 years beyond its expiration on September 30, 2011. Second, require the completion of a study within 18 months that thoroughly examines more far-reaching measures to permanently address problems with the NFIP, including how to terminate the insurance aspects of the program if strong movement toward fiscal soundness cannot be made, or how to revamp it so that private insurers assume a significant amount of flood risk. Third, enact legislation that addresses these broader recommendations.

The insurance component of the NFIP has proven unworkable because political pressure has kept flood insurance rates in many areas below the real cost of providing coverage. This has led to chronic taxpayer subsidies now totaling $18 billion. Much of this subsidy has led to risky coastal development, often by affluent builders and homeowners. The Federal Emergency Management Agency (FEMA) has been repeatedly criticized by the Government Accountability Office (GAO)[2] and many others for grossly mismanaging the program, especially the process of updating flood insurance maps. This has misled many people into concluding that it was safe to buy homes or start businesses in dangerous floodplains. FEMA has also failed to fix the costly "Write Your Own" (WYO) program, which allows private insurers who assume no flood risk to reap excessive fees for servicing flood policies, especially at times of severe flooding. The WYO program eats up one-third to two-thirds of the insufficient premium dollars and exposes taxpayers to unnecessary costs.

As meaningful changes to the NFIP to deal with these systemic problems have not been made, the time has come for Congress to begin the process of evaluating how to revamp the program to make it fiscally sound or to end the insurance aspect of the program and allow more effective alternatives to take its place. Such an evaluation could examine a number of factors, including: how to encourage private insurers to take some, and ultimately all, of the existing flood risk covered by the program; how the insurance part of the program could be phased out to spur such private risk taking; how low and moderate-income homeowners and renters could be protected from rate shock and provided with a targeted subsidy to help them afford private flood insurance while removing general subsidies for people who do not need them; and requirements that should be kept in place and improved regarding flood maps and construction in local communities.

**I. The Consumer Interest in Fixing the NFIP**

In assessing the potential impact of changes to the NFIP on consumers, it is important to note that most policyholders receive few if any subsidies under the program. Some consumers receive intended subsidies, such as those who own struc-

---

[1] J. Robert Hunter's Testimony on Flood Insurance before the Senate Banking Committee, October 2, 2007. *http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Hunter%27s__Senate__Testimony__Flood__Insurance__10-2-07.pdf;* Testimony of CFA's J. Robert Hunter before the Senate Banking Committee on Oversight of the National Flood Insurance Program, October 18, 2005. *http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Flood__Insurance__Senate__oversight__testimony__101805.pdf*

[2] "FEMA: Action Needed to Improve Administration of the National Flood Insurance Program", GAO-11-297, June 9, 2011; "Flood Insurance: Public Policy Goals Provide a Framework for Reform", GAO-11-429T, Mar 11, 2011; "GAO's 2011 High Risk Series: An Update", GAO-11-394T, Feb 17, 2011; "FEMA Flood Maps: Some Standards and Processes in Place To Promote Map Accuracy and Outreach, But Opportunities Exist To Address Implementation Challenges", GAO-11-17, Dec 2, 2010; "National Flood Insurance Program: Continued Actions Needed To Address Financial and Operational Issues", GAO-10-1063T, Sep 22, 2010.

tures built before the flood maps began being issued in 1974. However, many others benefit from unintended taxpayer subsidies that support unwise construction in the Nation's floodplains, which is exactly the opposite intent of the NFIP. The policyholders who benefit from these unintended and expensive subsidies include: the owners of structures in areas with flood maps that have not been updated; builders selling homes that appear to be safe from flood under outdated flood maps, but are not; and those who own "grandfathered" buildings in higher risk areas who FEMA still allows to pay older, lower rates, contradicting the program's intent.

CFA is often asked how a consumer group can favor bringing the NFIP into actuarial soundness, which will likely raise rates for some consumers. CFA strongly believes that the program should set fair, actuarially sound rates that accurately reflect the potential loss risk. However, the worst thing Government can do is run an "insurance" program that is not true insurance, but an unwise and untargeted subsidy program that misleads consumers into putting their homes, businesses, and lives at risk in areas that are dangerously flood-prone and that often unfairly subsidizes affluent individuals and contractors who do this building.

Homeowners who buy new homes in areas that they think are safe from floods are harmed when old maps underestimate risk. Some are misled into believing their homes are safe from floods when they build or buy new homes built to the old map's 100-year flood estimates that are, in fact, far below the real 100-year elevation. These people and their families are at risk of being killed or injured if a storm hits, or of having their homes or treasured possessions destroyed. Paying a little more and being truly aware of the risk is a blessing, not a curse, for consumers.

Other homeowners will look at these inaccurate flood maps and think, "I don't need insurance, I am way outside the risk area." But they are really well inside the area of high risk when the maps are old and development, erosion, climate change, and other impacts have caused the 100-year flood to rise significantly, as those living on the Gulf found out the hard way during Hurricane Katrina. CFA's study of Hancock County Mississippi flood maps after Hurricane Katrina hit found that the average map (of 76 in the county) was 20 years old and 10 feet too low in measuring the 100-year flood elevation.[3] Many home and business owners were misled into building unwisely, or not buying needed insurance, in the county where Hurricane Katrina hit, exposing the deeply flawed program's weaknesses in a most tragic way.

The current patchwork of general subsidies that drain the program of resources should be phased out. Targeted subsidies should be used to help low- and moderate-income people in flood-prone areas who cannot afford flood insurance. It is improper for the Government to require the purchase of insurance, as the NFIP does, and not help those who cannot afford it. It is also improper to give broad, hidden subsidies to consumers and call it "insurance." Targeted subsidies for those who are most in need would cost far less than the current mix of general subsidies, some of which appear not to have been authorized by Congress.

**II. Signs That the NFIP Is in Serious Trouble**

The NFIP was intended to end unwise construction in high-risk floodplains throughout the country, while providing affordable coverage for people who really needed it. In return for taxpayer funding for the development of flood risk maps and the provision of subsidized insurance for older buildings, new construction was to be done wisely, and full "actuarial" rates were to be paid for flood coverage. Over time, the subsidies would be phased out and the program would reach complete actuarial soundness.

The NFIP was brilliantly designed, but it has failed to live up to its promise. Politics and inept administration have made it a sort of Frankenstein monster, encouraging and even subsidizing unwise construction. Millions of consumers have also been misled into thinking their homes or businesses were not in harm's way, because FEMA has completely mismanaged the process of updating flood insurance maps.

*A. The NFIP is bankrupt, requiring billions of dollars in taxpayer support.*[4] Such a deficit would be acceptable for a short time if the program was doing what Congress intended, ending unwise construction in the Nation's floodplains and requiring inhabitants of floodplains to bear their own risk through actuarially sound insur-

[3] "An Examination of the National Flood Insurance Program", testimony of J. Robert Hunter, Director of Insurance, CFA before the Committee on Banking, Housing, and Urban Affairs of the U. S. Senate, October 2, 2007. *http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Hunter%27s__Senate__Testimony__Flood__Insurance__10-2-07.pdf*

[4] The current deficit is estimated at $18 billion by the GAO. GAO, "National Flood Insurance Program: Continued Actions Needed To Address Financial and Operational Issues", GAO-10-1063T, Sep 22, 2010. *http://www.gao.gov/new.items/d101063t.pdf*

ance premiums. However, the NFIP is doing the opposite of what Congress intended. These unwise subsidies will likely persist and worsen until the program is dramatically restructured or ended.

*B. This taxpayer subsidy is not just due to catastrophe losses, but is routine.* FEMA Administrator Craig Fugate testified before this Committee earlier this month that it is collecting $3 billion a year in premiums, but said that this amount would be $4.5 billion if coverage rates were actuarially sound. This represents an astonishing 50-percent shortfall in the amount collected.[5] If correct, this estimate means that, over the next decade, the current $18 billion NFIP deficit will almost double. From the beginning of the program until late 2009, the Congressional Budget Office (CBO) determined that the average annual taxpayer subsidy has been $1.3 billion for the known/intended portion of the subsidy involving structures that existed before flood maps were developed. What is more shocking is that the NFIP's actuarially rated coverage, which is supposedly self-supporting, has been priced 5 percent too low if paid catastrophic claims are not considered and an astonishing 100 percent too low if they are included.[6] Moreover, the GAO reported this month that the number of policies receiving subsidized rates has steadily increased recently and will likely continue to grow if changes to the program are not made.[7]

*C. NFIP subsidies are hidden.* FEMA administratively "grandfathers" rates from old maps when new maps are developed, which means that there is a hidden subsidy for structures covered by the NFIP from the old map. (FEMA allows new rates if the price drops but freezes the rate if the risk increases, as is usually the case.) This subsidy, which is not stipulated in law, means that the number of structures receiving subsidies will grow continuously. Absent a huge infusion of funds from Congress, the NFIP has no chance of paying back the borrowed funds or of building adequate reserves for future catastrophic flooding. Another hidden subsidy stems from old maps, which almost always show flood elevations that are too low because construction raises elevations over time. (See discussion below.)

*D. GAO found that the NFIP is a "high-risk" program for the American people.* GAO placed the program on the high-risk list in 2006 "because of the potential for the program to incur billions of dollars in losses and because the program faces a number of financial and management problems."[8] The GAO findings included: the NFIP could not generate enough revenue to repay the billions it had borrowed from taxpayers; the program would not be able to cover catastrophic claims that it paid in the future; oversight of the WYO program was weak, with potential for overpayment and inefficiency; FEMA does not study the program's expenses to see if WYO insurers are overpaid; the NFIP is actuarially unsound; maps are out of date; FEMA does not understand the long-term impact of planned and ongoing development on projected damage estimates; NFIP debt is likely to grow; and FEMA has not implemented its own financial control plan.[9]

*E. FEMA has created a Write-Your-Own program that overcharges taxpayers and policyholders and is riddled with conflicts-of-interest.* Considerable evidence has demonstrated that private insurers in this program overcharge for administrative and claims settlement duties[10] and that FEMA has repeatedly mismanaged this aspect of the program.[11] Additionally, FEMA refuses to broadly inform policyholders that they have an option to directly purchase flood insurance and potentially save taxpayers a considerable amount of money.[12] These WYO insurers also have a serious conflict-of-interest when they settle hurricane claims for the program, since they make more money if they determine that losses were caused by flood damage rather than wind damage. This is because taxpayers pay for 100 percent of flood claims under the NFIP, while WYO insurers must pay 100 percent of legitimate wind

---

[5] Testimony of William Craig Fugate, FEMA Administrator, before the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate, Hearing on Reauthorization of the National Flood Insurance Program, June 9, 2011. *http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing__ID=a2c7e4b9-5b4d-4635-befe-8ce662da1774&Witness__ID=bdf843f6-112e-4009-80bb-2cc0f50d92c8*

[6] *Ibid.*

[7] GAO, "FEMA: Action Needed To Improve Administration of the National Flood Insurance Program", GAO-11-297, June 9, 2011, p. 52. *http://www.gao.gov/products/GAO-11-297*

[8] *See,* GAO's listing of the NFIP problems at: *http:www.gao.gov/highrisk/risks/insurance/national__flood__insurance.php*

[9] *Ibid.*

[10] GAO, "Flood Insurance: Opportunities Exist To Improve Oversight of the WYO Program", GAO-09-455, August 2009. *http://www.gao.gov/products/GAO-09-455*

[11] GAO, "FEMA: Action Needed To Improve Administration of the National Flood Insurance Program", GAO-11-297, June 9, 2011, p. 26. *http://www.gao.gov/products/GAO-11-297*

[12] "Resources: Frequently Asked Questions", FEMA, May 26, 2011. *http://www.floodsmart.gov/floodsmart/pages/faqs/faqs__considering.jsp*

claims. Many Gulf Coast consumers are still in court dealing with claims that they believe should have been paid under their wind coverage.

*F. FEMA is far behind in keeping flood maps up-to-date.* "FEMA is not reviewing its flood maps every 5 years as required by law—older maps do not reflect significant changes in local conditions that tend to increase the risk of flooding." [13] Coastal erosion, climate change, urbanization, loss of wetlands, and other changes tend to make flooding worse. Old maps encourage construction in high-risk areas and subsidize such construction by charging actuarial rates with a hidden subsidy, which is the difference between what the old map would require to be charged and what the charges would be if the map were current. According to the GAO, 50 percent of the maps are over 15 years old and another 8 percent are between 10 and 15 years old. [14]

*G. FEMA does not take into account development that is already planned and in the process of being completed when a map is published.* By the time a map is printed, it is out of date. FEMA's own research shows the problem. In a test of what planned development would do to projected damages in the pricing model they use, FEMA funded a study that showed that it would raise projected damages by 20 percent in Fort Collins, CO, by 100 percent in Du Page County, IL, and Macklenberg, NC, and by a whopping 1,200 percent in Harris County, TX. [15] Ignoring what is planned means that a greater subsidy is built into the rate development process FEMA uses.

*H. FEMA is running into opposition as it updates its maps because communities are balking at adopting the much higher 100-year storm elevations now required.* Big increases in elevations are often needed, since FEMA allowed the Flood Insurance Rate Maps (FIRMs) to become so antiquated. FEMA has been too willing to compromise under political pressure from affected communities regarding the restrictions on development that are required. As a result, FIRMs are not being developed that will result in actuarially sound rates and properly elevated homes and businesses, and include all at-risk homes within the designated floodplains.

*I. FEMA is not ensuring that communities live up to their land-use commitments, the* quid pro quo *that Congress mandated for the creation of the entire program.* FEMA's own studies show the problem. It has a goal of visiting communities once every 5 years to promote, monitor, and enforce compliance. The real rate is only once every 10 years, however, "and only half of those contacts include a community visit. This is not a sufficient level of FEMA or State presence to maintain a level of monitoring necessary to avert compliance problems." [16]

Worse, even if problems of compliance are found, FEMA is timid. FEMA uses probation and suspension, the two sanctions they have to assure compliance, "only sparingly." As of June 23, 2010, less than 1 percent of the communities participating in the NFIP (212 out of 21,153) have been suspended from participating in the NFIP for noncompliance with the maps. Virtually all of the suspended communities appear to be small, rural towns. One study of the NFIP found that the threat of penalty is

> used so infrequently that there has developed a widespread perception that it is unlikely to be imposed in any given situation. This perception deprives the threat of its credibility and thus keeps recalcitrant communities unresponsive. Further, FEMA regional office and State staff themselves have grown to believe that they will never be able to succeed in having probation imposed on a noncompliant community, and their frustration is detrimental to an effective community compliance initiative. *FEMA should make an effort to act with deliberation on existing or future recommendations for probation action, with an eye toward reestablishing the credibility of this sanction.* [17] (Emphasis in original.)

This study also recommended that FEMA should undertake an investigation of State compliance with NFIP criteria, since FEMA regional staff and State officials do not "know whether the development activities of State agencies (are) in compliance with NFIP regulations." Finally, these 2006 FEMA studies found noncompliance with record keeping and construction requirements in the Community Rating

---

[13] "The National Flood Insurance Program: Factors Affecting Actuarial Soundness", Congressional Budget Office, November 2009. *http://www.cbo.gov/doc.cfm?index=10620*

[14] GAO, "Flood Insurance: FEMA's Rate Setting Process Warrants Attention", GAO-09-12, October 31, 2008. *http://www.gao.gov/products/GAO-09-12*

[15] "Managing Future Development Conditions in the National Flood Insurance Program", Blais, *et al.,* October 2006.

[16] "An Evaluation of Compliance With the NFIP Part A: Achieving Community Compliance", Monday, *et al.*, a study for FEMA, 2006.

[17] *Ibid.*

System (CRS) communities that were getting a rate break for complying well with such requirements. This “affects the viability of the flood insurance fund even more than noncompliance in other communities.”[18]

Anyone who walks barrier islands on the Nation’s eastern and Gulf Coasts and looks at recent construction along the beaches will know that the NFIP has failed to stop unwise construction at high-risk locations. It does not take an engineer to find relatively new structures that are at high risk and are not safe from storm surge. For years, CFA has been urging FEMA to create an enforcement program administered by an independent party, like the GAO, that would conduct spot checks to see if local building enforcement is occurring, even regarding the current inadequate maps, but FEMA has not done so and Congress has not required it.

*J. Instead of challenging communities that refuse to make land-use improvements as required by updated rate maps, FEMA offered “preferred risk” policies that underprice insurance.* As detailed by the GAO in their most recent critical report of FEMA’s management of the NFIP, FEMA recently created a new coverage option called the Preferred Risk Policy (PRP) Eligibility Extension that lowers rates for up to 2 years for policies that would have converted to higher premium costs upon renewal.[19] This is an unauthorized give away of taxpayer money to subsidize high-risk structures for no reason other than the fact that new maps had raised required building elevations. Giving high risk people below-cost rates for 2 years is an unjustifiable increase in taxpayer subsidies. If a subsidy is needed, it should be targeted to policyholders who have low or moderate incomes. General subsidies should be ended.

*K. FEMA has mismanaged the NFIP’s policy and claims management system at considerable cost to taxpayers.* The GAO found that FEMA spent 7 years and $40 million dollars to create a new policy and claims management system called “NextGen” that it canceled in November of 2009 because it was ineffectual. “As a result, the agency continues to rely on an ineffective and inefficient 30-year old system.”[20]

*L. State Farm Mutual Insurance Company stopped servicing flood insurance policies for the Federal Government last fall, causing 829,273 NFIP policyholders to scramble for coverage.* State Farm blames Congress and FEMA for poor administration of the program. The move is also at least equally likely to be related to State Farm’s long-term strategy to significantly reduce its home insurance risk along the Nation’s coasts. FEMA’s spokesperson Rachel Racusen says that these policyholders will be just fine because they will be able to continue to use State Farm’s agents “or one of the other 90 insurers that sell flood insurance through the NFIP.”[21] However, this approach will likely cost taxpayers millions of dollars and result in poor customer service. It would be a mistake to allow “captive” State Farm agents to work for another WYO carrier because these agents are only responsible to State Farm. They are not prepared, trained, equipped or otherwise ready to deal with another company. Only so-called “independent” agents have such experience. Additionally, WYO companies cost about twice as much administratively as FEMA’s contractor, which handles the direct program of flood insurance for FEMA. Removing the agent and using the direct contractor would reduce overhead and profit-costs for the State Farm policies by about two-thirds, saving millions of taxpayer dollars.

*M. If FEMA were to try to make the program more actuarially sound, existing law limits that possibility.* Currently, rates cannot rise more than 10 percent a year. Limits on 1-year rate increases are necessary because consumers need time to adjust to insurance price increases but 10 percent is too low. The House proposal to raise the allowable rate increase to 20 percent makes more sense.[22] However, it is important to note that this limit is not related to income or any measure of the ability of homeowners to pay increased rates. This means that a substantial portion of the NFIP subsidy will likely continue to be provided to affluent homeowners living on barrier islands, or near lakes and other waterways.

*N. Congress has allowed the NFIP to lapse several times recently, creating uncertainty and instability in the program.* As an insurance executive recently put it, “this is now the fourth time Congress will have let this program lapse, and it’s be-

[18] *Ibid.*

[19] GAO, “FEMA: Action Needed to Improve Administration of the National Flood Insurance Program”, GAO-11-297, June 9, 2011, p. 53. *http://www.gao.gov/products/GAO-11-297*

[20] GAO, “FEMA: Action Needed to Improve Administration of the National Flood Insurance Program”, GAO-11-297, June 9, 2011, p. 57. *http://www.gao.gov/products/GAO-11-297*

[21] “State Farm Won’t Handle Claims for Flood Insurance Program”, *National Underwriter,* June 7, 2010.

[22] H.R. 1309, Flood Insurance Reform Act of 2011, Section 5(a).

ginning to feel like 'Groundhog's Day,'" said Blain Rethmeier, a spokesman for the American Insurance Association.[23]

*O. Until now, Congress has been unwilling to stop the trend toward making NFIP more of a giveaway program to some consumers and businesses than an insurance program with sound risk management.* Overall, Congress has not moved fast enough to lift woefully inadequate limits on flood insurance rates to allow the program to move to actuarial soundness, which is undermining hope for a self-sustaining NFIP anytime in the near future.[24]

*FEMA's Response to Systemic Problems at the NFIP*

In his testimony before the Committee on June 9th, FEMA Administrator Craig Fugate acknowledged many of the systemic problems with the NFIP that I have cited, but offered little information and no details regarding what the agency will do to address long-standing and well-documented concerns about its management of the NFIP. It is of particular concern to CFA that he provide no information about how FEMA intends to cut the excessive costs of the WYO program or overcome the wind/water conflicts-of-interest that exist for insurers who participate in the program. I understand that the agency is in the middle of a lengthy effort to review proposals for NFIP reform. However, after years of concern about the direction of the NFIP from Congress, the GAO and outside organizations, the Senate deserves a more specific, urgent reform plan from FEMA.

**III. The Future of the NFIP**

As mentioned above, CFA recommends that Congress evaluate far-reaching, longer term measures that would either permanently fix fatal flaws in the NFIP, such as ideas for getting private insurers to assume substantial flood risk, or that would phase out the program in a responsible manner and create effective, affordable alternatives. While this research is being done, we recommend the adoption of legislation that would take steps to bring the program back towards solvency and that would extend it for no more than 2 years.

*A. Congress should study ending the NFIP to correct fatal flaws.* If Congress were to decide to end the systemic problems with the NFIP described above, the only responsible way to do so would be to make sure that the program becomes fully actuarially sound. However, to date, strong political pressure on Congress and from Congress, as well as from State and local leaders, has prevented the program from becoming actuarially sound. It is likely that developers will continue to find loopholes to let them build unsafe structures, politicians will resist community suspension, and higher (but proper) rates will not be allowed.

The only counter-weight to this one-way pressure to soften the program's impact on communities, developers and consumers at taxpayer expense would be to encourage private insurers to get more involved in at least some of the risk-taking aspects of the program. If the private sector has some "skin in the game," then there would be pressure brought to bear by insurers to make sure maps are accurate and enforced, updated actuarial rates were used and that everyone was doing all things necessary to make the program effective and to protect the taxpayer (and the insurer's) bottom line. Insurers would resist pressure from politicians and developers to lower rates below cost. Politicians would resist pressure from insurers to have rates that were excessive. These checks and balances would help keep flood insurance prices reasonable but adequate.

However, many private insurers will not jump at the opportunity to underwrite more flood risk. Many are in the midst of significantly cutting back on the coverage they offer on the coasts because of wind risk. As private sector participation in the risk-taking aspect of NFIP is questionable, it is necessary to study the possibility of protecting taxpayers by ending the insurance component of the program in a responsible way that protects vulnerable consumers.

The point of the study would be to evaluate potential outcomes if the program is ended and to develop a transition plan that allows all affected parties to prepare for the consequences of such an event. The transition plan will be complex and must be done with great concern for the current inhabitants of floodplains, particularly NFIP policyholders. CFA recommends that Congress task the GAO and FEMA with evaluating the following specific topics when making recommendations about how to end the NFIP, as part of the legislation to extend the NFIP beyond September 30, 2011.

---

[23] "NFIP Lapses Again Due to Senate Inaction", *National Underwriter*, May 28, 2010.

[24] NFIP is an insurance program and is not designed to be a charity program. The current subsidies are disbursed indiscriminately, with no test of the ability of the subsidy recipient to pay the real cost of risk of the structure he or she owns.

*1. Ending only the insurance part of the program.* (As stated below, accurate and up-to-date FIRM information on risk is vital if any private sector insurance underwriting is to become viable.) Ultimately, after a long transition where the Federal Government participates in risk taking either directly or through reinsurance, a private market could develop if there is accurate and current risk information and safe construction in the floodplains.

*2. Providing a long transition period to allow all parties time to adjust to the lack of a Federal insurance program.* Thirty years, for example, would provide time for the Government to gradually phase out its subsidies, for insurers to determine how to underwrite flood risk and for consumers to find alternatives to the NFIP.

*3. Phasing out the provision of insurance over this period.* A likely first step in the phase-out process would be for the Federal Government to stop writing new business. Even this measure would have to be done in a way that allowed safely constructed new homes to receive mortgages through the provision of clear, accurate information on flood risk to lenders.

*4. Protecting LMI homeowners and renters.* Congress could likely end the NFIP over a 5 or 10-year period if not for the need to protect LMI consumers from rate shock. The study should consider providing an ongoing subsidy to LMI homeowners during the transition and even after some degree of private insurance enters the market.

*5. Requirements that should be placed on communities in floodplains and on FEMA regarding flood maps.* Keeping the mapping and community participation requirements in current law would provide private insurers with sufficient information to begin to take risk. This knowledge base is vital to encouraging a private response. Insurers will need information to help them write coverage for structures at actuarial rates and to have an ability to determine which communities are requiring safe building in floodplains to help them focus their insurance capacity. When HUD did its 1966 Feasibility Study into why flood insurance was not privately available at the time, it found that the factors were:

- Lack of any way to accurately determine pricing (*i.e.,* no mapping of the flood risk);
- Consumers knew more about the risk of flood than the insurers, which meant that there would be adverse selection by people against any price insurers set;
- If prices were raised, only people at higher and higher risk would buy the insurance;
- No one was controlling new construction, so changes up or down stream could make prices for insurance too low;
- Lenders did not require flood insurance.

Unlike 1966, we now have the ability to solve many of these old insurance concerns. Maps, if they are kept up-to-date, can calculate rates that are actuarially sound for every structure. Adverse selection is minimized since lenders in the high-risk floodplains now require all building owners to get flood insurance. Floodplain management is in place as a condition of flood insurance availability in a community.

*6. Encouraging private insurers to take some, and ultimately all, of the existing flood risk.* This could be done either on a property-by-property basis or with some overall sharing of risk. The sharing might start with the Government taking 95 percent of the risk and setting actuarial rates that would have to be paid. Insurers would initially assume 5 percent of the risk and set rates for those structures they would underwrite. FEMA could advertise which insurers were selling flood insurance in its "Flood Smart" ad program. Over time, the Government's percentage of the risk would decline. In order to incentivize insurers to participate, the Government could develop a stop-loss reinsurance program, which caps the private insurer annual exposure to loss.

*7. Mandating the purchase of flood coverage. If flood insurance is unavailable, there should obviously be no requirement to purchase it.* On the other hand, if the private market does develop, a purchase requirement might allow insurers to effectively spread their risk. This would further increase their ability to soundly underwrite flood coverage. Whether and how to mandate purchase during the transition is a key question the study must consider.

*B. The Senate Flood Insurance Reform and Modernization Act of 2007 (S. 2284) is the best starting point for making much-needed incremental changes to the NFIP.* S. 2284 takes several very important steps to protect taxpayers, increase the market penetration of flood insurance, and eliminate unjustified subsidies in the flood program. In particular, the bill would phase out subsidies for vacation and second homes, properties built before the availability of Flood Insurance Rate Maps

(FIRMs), and structures that have experienced severe repetitive losses. It would also require the NFIP to build reserves over time, add a 500-year floodplain to the flood maps, and require the evaluation of flood risk behind dams and levees. It would also take the important step of creating a flood insurance advocate's office to assist those with flood coverage in resolving problems with the NFIP and add deductibles to NFIP policies.

CFA recommends that the Committee add provisions to this bill that would move the NFIP even more quickly towards solvency, so that it will become financially viable over time and be there for homeowners who need it. The bill should require a study of NFIP to determine the steps needed to make it fully self-sufficient, including the review detailed above on how to increase private insurer underwriting of flood risk or to responsibly end the program should self-sufficiency be unattainable. Just studying these possibilities will demonstrate that Congress is serious about making the program viable for the long term. The bill should also increase the cap on allowable rate increases per year from 15 to at least 20 percent. Finally, in order to give Congress a meaningful opportunity to make needed, more far-reaching changes to the program that result from required studies, the bill should only renew the NFIP for 2 years, instead of five.

*C. House legislation to renew the NFIP (H.R. 1309) has significantly improved over previous House bills, but still contains some damaging provisions.* (This bill has been marked-up this year by the House Financial Services Committee and is currently on the House Floor.) On the positive side, the bill allows rates to rise by 20 percent annually, rather than the 10 percent cap in the current program. It adds mandatory deductibles to NFIP policies. It phases in full actuarial rates a bit more slowly than we would like to see (at 20 percent of the required increase per year over 5 years) for commercial properties, second and recently purchased homes, existing policyholders, severely damaged homes, and repetitive loss homes. No subsidy is allowed on lapsed policies. It also protects those who are required to purchase high-priced "forced-placed" coverage by requiring repayment to the borrower for any coverage that is paid for under a forced-placed policy in force at the same time an NFIP policy is in place.

The bill also requires some important studies within 18 months of the effective date, including both a FEMA and GAO report on how to privatize the program. FEMA is also required to report annually on its ability to pay claims with and without authorized borrowing authority. It must study community-based flood insurance and adding building code requirements to floodplain management standards. Finally, the National Academy of Sciences must evaluate how to do a "graduated risk" assessment of flood risk behind levees.

The bill also contains several negative provisions. FEMA is permitted to suspend flood insurance purchase requirements for 1 to 2 years for several questionable reasons: (1) if an area has no history of flooding, even though the science underlying the new maps that show increased flood risk is sound; (2) if a community says it is upgrading a levee or dam that has been decertified because it can't provide 100-year flood protection, even when improvement efforts are not complete; or (3) when someone appeals a requirement to purchase insurance.

The bill also contains several provisions that will increase the cost of the program and taxpayer exposure. It allows maximum policy coverage to be indexed according to the cost-of-living. Coverage for loss-of-use is also added. Maximum coverage benefits will be indexed. It also requires policy rates in newly mapped areas to be significantly less than what is actuarially required for the first year of coverage.

The bill authorizes FEMA to purchase private reinsurance, which is silly and unnecessary, given the financial ability of the Federal Government to cover losses. It is analogous to requiring a very large insurance company, such as State Farm or Lloyd's of London, to seek reinsurance from a very small, single-State reinsurer. Moreover, when a big insured event occurs, reinsurers often suspend coverage or overreact by making rates too high, [25] which will further increase Federal costs.

The bill also increases the chances that taxpayers will be overcharged by the WYO program by requiring that those who are insured through the more-efficient and less-costly direct program be notified that they should consider finding a WYO company. Since WYO program costs are significantly higher than those of the direct program, this requirement encourages policyholders to make a choice that will cost taxpayers more money. Even worse, the bill requires FEMA to study how to keep participation in the direct program under 10 percent of the NFIP portfolio, even if WYO costs continue to be too high.

[25] As a leading reinsurance executive told Hunter, reinsurers often get "too greedy" when a big event opens the door for price gouging.

Finally, the bill renews the NFIP for 5 years, instead of two. As mentioned above, this is too long to renew a program that needs far-reaching changes, which will be recommended in the bill's mandated studies.

*D. The COASTAL Act of 2011 is well-intended, but unnecessarily complex and probably unworkable under FEMA's management.* The Consumer Option for an Alternative System To Allocate Losses Act of 2011 (S. 1091) was proposed this year by Senator Wicker. This bill does more to ease the NFIP shortfall than the current program, with an allowable 20 percent annual cap on rate increases and mandated full actuarial rates on new and lapsed policies. It also does not raise program costs by increasing coverage limits or adding new loss-of-use coverage. It requires State-charted banks to mandate the purchase of flood insurance when underwriting mortgage loans, but insurers that do mortgage lending do not have to meet this requirement. However, the bill does not require study of how to get private sector involvement or how to cut the systemic program deficits, both of which are very important to bringing the program back into solvency.

As with the 2007 Senate bill and the House bill, this legislation extends the NFIP for 5 years without making broad reforms. This is too long for Congress to wait to take the further steps recommended by the studies required in final legislation.

The centerpiece of the bill is a system to handle wind and water claims that is unnecessarily complex and probably unworkable. It requires FEMA to come up with models to calculate wind speed and storm surge whenever a named storm hits. These models must be accurate to 90 percent, but it is quite unclear exactly what such a 90 percent standard requires. (As written, the requirement is statistically meaningless.) The bill requires a massive effort to develop these models involving data collection from academics, private persons, State and Federal agencies, and so on. It would even require storm "sensors" to be put along the coasts.

When adjusters find a loss to be "indeterminate," because they are unable to tell which losses are due to wind damage and which are from water damage, the as-yet-unavailable data from the massive collection effort will be plugged into a yet-to-be-determined formula the Administrator of FEMA will create. The formula would include the property's FEMA Flood Elevation Certificate and other information the Administrator would like to use. Taken together, these very complex requirements seem quite inappropriate for an agency that has had serious, well-documented trouble managing relatively simple NFIP requirements, such as the WYO program and the mapping of floodplains, where the science is mature.

Wind and flood insurers are required to use this method to distribute losses. Other insurers "may" use this process if the policyholder agrees to it at the time of policy sale. There is no judicial review of this formula, or the data that is used to create it. However, there is an appeal to a five-member Arbitration Panel. Prior to the allocation, insurers can do a "good faith" allocation and true it up when the formula results are known. All this relates only to "indeterminate" claims. Other claims will rely on good faith between wind insurers and FEMA. Disputes here are also to be sent to the Arbitration Panel.

The method proposed in this legislation for accurately assessing wind *versus* water claims is unnecessarily complex and costly. A look at what private insurers do when faced with apportioning costs from losses is instructive. Large property/casualty insurers do not bother to balance out subrogations they have between themselves after auto accidents since there are so many claims and they have learned that doing a lot of research on each claim is not required, since the costs between insurers even out over time. Therefore, it makes no sense with flood insurance to try to be so complex. The law of averages will lead to a fair division between wind and water claims over time. All that is needed are three things: a Federal claims adjusting contractor to do all of the adjusting of flood claims; an occasional GAO audit of the WYO carriers to make sure their apportionments are not biased on the wind claims; and for FEMA to disallow insurer use of anticoncurrent causation clauses, which allow them to refuse to pay wind damage if flood damage occurred to the insured property at the same time. If apportionment bias is occurring, FEMA must then initiate enforcement actions against WYO companies by removing them from the program.

After this monumental effort, the Wicker bill allows the policyholder and insurer to agree to opt-out of this approach. It also allows an insurer to opt-in so that every one of its claims from a named storm will be done using this method. (It seems unlikely that many insurers would want to opt-in, however.) In sum, the goal of the legislation is laudable, but the methods it requires will create a lot of bureaucratic difficulty and would likely fail.

Thank you for the opportunity to offer CFA's thoughts on reform and reauthorization of the NFIP.

## PREPARED STATEMENT OF SCOTT H. RICHARDSON

POLICY ADVISOR, THE HEARTLAND INSTITUTE, AND PARTNER, RICHARDSON AND RITCHIE CONSULTING

JUNE 23, 2011

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I am here today to address an issue of great concern to the National Flood Insurance Program's future and to explain how a proposal that has been brought before your Committee by Senator Roger Wicker presents what I believe is a solution to a problem that has long plagued coastal communities.

As a former insurance agent, member of the South Carolina State Legislature, and Director of Insurance of the State of South Carolina, I have seen the difficulties that coastal communities, their residents, insurers, courts, and insurance regulators—in short, just about everyone involved in coastal insurance—face in the course of dealing with severe windstorms. I speak, of course, of the problem of indeterminate loss. The problem of what is to be done when a storm is so severe that it leaves nothing in place to determine whether wind or water caused damage.

This is a particular problem because it undermines the insurance system that undergirds our entire modern economy by allowing for certainty. Insurance allows people to build skyscrapers, develop miracle drugs, advance technology, drive automobiles, and operate businesses with the knowledge that the risks implicit in doing these things will be managed in an effective manner. Our current system for managing the risk of severe windstorms does not create that certainty. Indeed, it creates uncertainty. It is broken and it needs to be fixed.

In this testimony, I aim to outline the problem of indeterminate loss, describe how the current flood/wind loss allocation system fails many communities, outline why other solutions are not practical, describe how a Standardized Loss Allocation Model would work, go over several public policy concerns involved in implementing a Standardized Loss Allocation system, and describe how I believe it will solve the problem of indeterminate loss.

### The Problem of Indeterminate Loss Resulting From Windstorms

Hurricanes rank among nature's most destructive phenomena. High winds, wind-driven debris, and the storm surges that follow hurricane landfall can do enormous damage to everything in their paths. In many cases, over areas of several miles, all above-ground traces of buildings can be torn apart, leaving nothing but foundation slabs in place. [1] I have seen total losses myself: what remains after a particularly severe storm resembles a moonscape.

Because they combine high winds with storm surge, hurricanes cause both wind and water-related losses in very close proximity to one another. When nothing above remains of a structure and both wind and storm surge were sufficient to cause its total destruction, claims adjusters, consumers, and insurers currently have no practical way to determine how to distribute losses between NFIP, which provides nearly all flood coverage, and private insurers or State residual wind insurance markets, who cover wind and related damage. When a home is totally destroyed, there's no simple way to resolve disputes over who should pay for losses. When this happens, the current U.S. system for paying insurance claims can cause enormous problems for consumers, insurers, and regulators. The problems are most serious when people do not have flood insurance and therefore try to get insurers that sell wind insurance policies to cover damages that may have resulted from flood. Insurers often refuse these claims and say flooding (which they do not cover) caused the damage, leaving consumers with little recourse besides litigation. [2] This, in turn, can lead to enormous and protracted legal battles among insurers, consumers, and regulators.

### The Problems Communities Face and the Inadequacy of Other Solutions

Following the terrible 2005 hurricane season—the season of Hurricanes Rita, Wilma, and Katrina—nearly all States impacted by major hurricanes saw significant litigation between insurers and insured over responsibility for wind and water claims. Many of these legal disputes stretched over months and years. Many people

[1] A good example of the total destruction that can result from a hurricane and the damage it causes can be found at Dan Swenson and Bob Marshall, "Flash Flood: Hurricane Katrina's Inundation of New Orleans, August 29, 2005", *New Orleans Times Picayune,* September 13, 2005, *http://www.nola.com/katrina/graphics/flashflood.swf.* See also "Total Devastation from Hurricane Katrina", *http://www.katrinadestruction.com/images/v/hurricane+katrina+photos/Img__19kd45-slidell-katrina-lr2.html.*

[2] Jihyun Lee, *et al.,* "Flood Insurance Demand Along the Gulf and Florida Coast", Southern Agricultural Economics Association, 2010, *http://ideas.repec.org/p/ags/saea11/99239.html.*

and many communities did not get the resources they needed and deserved to rebuild. The costs of litigation, of delayed rebuilding, and of damage to the fabric of communities, were all immense.

Fundamentally, these problems exist because separate parties are responsible for paying for wind and water damage. A huge incentive exists for insurers and consumers alike to shift the responsibility for paying any given claim to someone else and, right now, it's difficult (sometimes impossible) to determine what (and therefore who) is responsible for any given damage.

Proposals have been made to solve this problem by unifying responsibility for flood and wind damage. If a single party is responsible for covering both flooding and wind damage, the problem of indeterminate loss would no longer exist. In principle, I believe that this unification of responsibility under private insurers is a worthy long-term goal. Many provisions in the flood reform bill before you would increase the private sector role in the flood insurance program but, based on my knowledge of the insurance industry, I simply do not believe that the major private insurers could or would cover all flood risk in the near future. Thus, even if you take every step towards privatization of the flood insurance program that has been proposed, the problem of indeterminate loss will continue to exist for some time.

Thus, if Congress is not to privatize flood insurance entirely, it ought to come up with another solution to the problem of indeterminate loss. And I believe that a Standardized Loss Allocation model as Senator Wicker's COASTAL Act envisions is such a solution.

**Standardized Loss Allocation—How It Works**

Under a Standardized Loss Allocation (SLA) system, insurers, NFIP, and State-run or State-mandated residual insurance markets such as wind pools and Fair Access to Insurance Requirements (FAIR) plans would agree in advance to distribute liability based on standardized loss allocations models. The sizes of the distributions would be based on extrinsic, meteorological evidence. This approach would solve almost all of the problems implicit in the current system and could potentially save money for both NFIP and private insurers. Implementing it properly, however, will require the collection of more meteorological data. I'd like to use the remainder of my testimony to describe how it would work and what public policies should be implemented to make sure that it is effective.

**How an SLA System Would Work and How It Solves Problems**

An SLA system would begin by establishing a model for assessing the damage resulting from each major storm based on four major inputs: direct observations, information about building characteristics, indirect aerial observations of storm surge, and widely used storm models. Direct observations are what they sound like: direct information, collected by scientific instruments about wind speed and storm surge. Information about building characteristics—particularly elevation information that would provide input as to the consequences of storm surge—is not always included in current insurance underwriting standards but is necessary in certain cases to determine the exact damage resulting from storm surge. Aerial observations collected during and immediately after a storm (as well as satellite imagery collected during a storm) could provide additional information on storm surge since few instruments can withstand the most severe storm surge. Finally, a wide range of storm modeling techniques would work together to build a model that could, ideally, provide a very good estimate of the extent to which wind or water caused the damage to a given structure. The National Oceanic and Atmospheric Administration and several private-sector modeling firms already have created such models; building a standardized national one would not require significant additional scientific work.

**Public Policies To Implement an SLA System: Improved Data Collection**

All this said, some minor public policy changes would have to be made to assure the success of an SLA system. These would primarily involve improving data collection. Although the scientific instruments and mathematical techniques needed to develop a standardized loss allocation model already exist, there are places where data collection could be improved. This is not universal: Particularly along the Gulf Coast, the Coastal-Marine Automated Network (C–MAN) already provide the data now needed. In some other areas—areas further from the coast and thus less likely to be hit by hurricanes—the available data may not be quite as good and measures should be undertaken to improve data quality over time. Senator Wicker's COASTAL Act asks the National Oceanographic and Atmospheric Administration to form partnerships with private entities, other Federal agencies to place new sensors on Federal Government property. It also envisions paying some or all of the costs for keeping an expanded network in place by leasing space on new observation posts (many of them on existing Federal property) to mobile phone providers, other weather-related businesses, and anyone else who has need for such access. This particular funding approach certainly has promise, but Congress, the Federal Emergency Management Agency (which oversees the flood program), NOAA, and State and local agencies should, over time, consider other proposals as well.

**Public Policies To Implement an SLA System: Making the System Universal But Voluntary**

A standardized loss allocation system is a good idea but it should not become a straightjacket. There are far too many unknowns for it to be wise to force the system on every consumer, every community, every insurer, and every insurance agent in the country. Instead, participation should be voluntary.

To facilitate universal but optional participation, NFIP should participate in an SLA model for all policies written under the Write Your Own program and not participate in it for most policies written by independent agents under NFIP Direct. This is the approach that Senator Wicker's bill takes and it is one I believe that the Committee should take care to continue and to clarify in the bill's legislation language.

A voluntary system will provide a choice to all consumers, insurers, and State residual insurance market mechanisms. Individuals who want to opt out of the SLA program can purchase a direct policy, since nearly all independent insurance agents in the country will write them, and thereby get the same flood coverage at the same price as they would otherwise. Private insurers and residual insurance market mechanisms that don't want to take part can simply leave (or never join) the Write Your Own program. In short, it seems possible to make SLA-based policies an available option for almost everyone without mandating them for anyone.

**Conclusion: An SLA System Is Better**

An SLA system would work better than the current system. For those participating in the system, the model essentially would end litigation, assure payments to consumers, shore up NFIP finances, and provide certainty to NFIP itself. With payments determined by formula alone, there would be little to litigate: The use of the model would be written into policy language for both NFIP and private-sector coverage, and anyone challenging it in court would have to present expert scientific testimony indicating why the model was invalid. If anyone went through the trouble to do this, it would probably help improve the system by pointing out flaws in the models.

Customers, even those who live in flooded areas but lack flood insurance, generally would be assured of at least some payments from their wind insurance policy rather than outright claims denial. NFIP itself, likewise, would rarely if ever face the prospect of having to pay the full cost of damage caused in part by wind. Insurers, finally, would have the same assurance, that they would never have to pay total losses when flood has done part of the damage. Quite simply, an SLA system promises to be less expensive, more certain, and more efficient than any currently available alternative.

I am delighted to take your questions.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

## STATEMENT SUBMITTED BY THE AMERICAN INSURANCE ASSOCIATION

The American Insurance Association (AIA) is pleased to submit this statement as the Committee considers proposals to reform and reauthorize the National Flood Insurance Program (NFIP). AIA appreciates the Committee's attention to this important issue.

AIA represents approximately 300 major U.S. insurance companies that provide all lines of property and casualty insurance to U.S. consumers and businesses, writing $100 billion annually in premiums. AIA and several of its members are also members of the "Write-Your-Own" Flood Insurance Coalition (WYO Coalition), a group that includes private insurers that participate in the NFIP Write-Your-Own program.

### Background

The NFIP's current authorization expires on September 30, 2011. Prior to its current 1-year extension, the NFIP has experienced repeated short-term extensions, including four actual lapses when the program was effectively unable to write new or renewed business. Those lapses hindered numerous consumer housing closings and caused significant uncertainty for our Nation's millions of NFIP policyholders, as well as real-estate professionals, lenders, and insurers. AIA and its member companies believe that a long-term extension, combined with essential reforms, is needed to bring stability and certainty to the program.

A cornerstone of AIA's proactive natural catastrophe agenda has been meaningful reform of the NFIP. When considering NFIP reforms, AIA and its members start with the following principles: (1) program certainty is first and foremost; and (2) premiums need to better reflect risk.

Following from these two principles, AIA recommends several reforms for the Committee's consideration. Many of these reforms were included in 2008 legislation previously approved by the Senate and are in legislation (H.R. 1309) that the House Financial Services Committee recently passed.

Specifically, any legislation to reform and reauthorize the NFIP should include: (1) a meaningful long-term extension of the program; (2) movement toward risk-based premiums; (3) a reduction in price subsidies; (4) deductible increases that help increase program capacity while encouraging mitigation by consumers; (5) an increase in coverage limits that have not changed in more than 15 years; and (6) authorization for the purchase of additional living expense coverage (residential) or business interruption (commercial). Again, many of these reforms were included in legislation (S. 2284) approved by the Senate in 2008.

### Meaningful Extension/Reauthorization of the Program

AIA has advocated for a long-term reauthorization of the NFIP to protect consumers and help increase stability for real estate transactions and policyholders. AIA believes that a long-term reauthorization, such as a 5-year extension, will provide certainty in the flood program thereby increasing consumer and business confidence in the NFIP. Moreover, AIA believes that a long-term extension is necessary to allow for meaningful rate and premium appreciation so that the program may get on a solid financial footing and allow prices to more accurately reflect risk.

### Premiums Reflecting Risk

The NFIP must ensure that premiums for coverage reflect the true costs to taxpayers so that flood loss subsidies can be eliminated over time. Understanding that this could cause significant hardship for those who cannot afford true risk-based premium payments, a possible solution is a Government premium subsidy that could be provided outside of the NFIP. We believe this could be less expensive to taxpayers than flood loss subsidies and would likely result in more coverage being purchased while reducing cross-subsidies that make the program less attractive to many potential policyholders.

Legislation approved by the Senate in 2008, as well as H.R. 1309, take positive steps toward better pricing NFIP coverage. Both bills would increase the permissible annual premium—the so called "elasticity band" and move toward actuarial rates for a variety of properties—(1) commercial properties, (2) second homes and vacation homes, (3) homes sold to new owners, (4) homes damaged or improved, (5) homes with multiple claims, and (6) pre-FIRM properties. These are all positive steps that move the program toward a better financial position.

**Changes to Coverage**

WYO insurers help administer 95 percent of the NFIP business providing market penetration, innovation and efficiency. Unfortunately, the number of homeowners and businesses purchasing flood insurance has dropped from its peak following the 2005 hurricane season. In order to maximize the program's effectiveness and reduce its reliance on the treasury, participation in the NFIP needs to continue to grow and consumers should be encouraged to purchase flood coverage.

For several years AIA has supported changes in flood coverage to make the product more attractive. These include: (1) increasing coverage limits which will mean fewer uncovered losses for consumers while allowing greater premiums to be collected by the program; (2) increasing deductibles which will allow consumers to save more on premiums by assuming greater risk while encouraging mitigation; and (3) allowing the purchase of additional living expense coverage (residential) or business interruption coverage (commercial) thereby providing consumers with greater product options.

Undertaking these steps will increase product diversification which should encourage more consumers to consider purchasing NFIP flood coverage.

**Other Proposals Being Considered**

During the continuing discussions to reauthorize and reform the NFIP several additional proposals have been brought forward. One such proposal centers on the notion of immediately "privatizing" the flood insurance program. AIA strongly supports an open and free market environment; however, the NFIP was created precisely because the private insurance market could not write flood insurance on an economically feasible basis in the vast majority of instances. The NFIP arose from the simple fact that prior to 1968, for all practical purposes, flood insurance that was both actuarially sound and affordable was unavailable to the home-owning public because it was subject to such acute adverse selection (only those who need it would purchase it). Indeed, long before the creation of the NFIP, private insurers had effectively stopped providing flood coverage.

While it constitutes a declining percentage of all NFIP policies, the number of properties receiving subsidized premium rates has grown since 1985; by 2007 it was at its highest point in almost 30 years. To date, more than half of the subsidized policies are concentrated in five States with relatively high flood risk. Based on our experience, these subsidies would not vanish if the NFIP were privatized. Unfortunately, in many States—including those States that are exposed to losses by natural catastrophes—insurers face arbitrary rate suppression. That said, any discussion of privatization of the NFIP or large portions of it must be carefully considered.

Another suggestion is a proposal by Senator Wicker. Senator Wicker recently introduced the COASTAL Act, (S. 1091), which proposes a new approach to adjusting total losses in which both flood and wind played a role and yet remaining physical evidence is scant or nonexistent. For such claims, the legislation proposes the use of a new post-event model to produce a formulaic allocation of total losses between certain wind and flood coverages when both are present. This is a significant departure from long standing NFIP and wind claims adjusting and how they are governed by Federal and State law, respectively. As with any new idea that could impact a large, important program, AIA believes this allocation proposal needs proper consideration and study to ensure that it will not result in unintended consequences.

**Conclusion**

As we noted at the time, AIA supported many of the provisions contained in the 2008 Senate legislation, particularly those provisions providing for a long-term reauthorization and those that put the program on sound financial footing. Thank you for the opportunity to submit this statement. We look forward to working with the Committee as this process moves forward.

---

**STATEMENT SUBMITTED BY STUART MATHEWSON, FCAS, MAAA, CHAIR, FLOOD INSURANCE SUBCOMMITTEE, EXTREME EVENTS COMMITTEE, ON BEHALF OF THE AMERICAN ACADEMY OF ACTUARIES**

Chairman Johnson, Ranking Member Shelby, and distinguished Members of the Committee, on behalf of the American Academy of Actuaries' Subcommittee on Flood Insurance, I appreciate the opportunity to provide testimony regarding the National Flood Insurance Program (NFIP).

The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policy makers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

The NFIP is a complex program and is perceived by some/many as having a selective impact within certain areas. Nevertheless, critical factors stemming from constantly changing climate, coastlines, rivers and streams, building construction, land-use, the scientific understanding of hydrology and hydraulics and the technologies used to measure and address flood risk create new opportunities for constructive NFIP reform.

Two issues are of the highest priority with respect to the NFIP. First, we support reauthorizing the program for a period of time of 5 years or longer to establish some stability in flood insurance coverage. This will help stabilize the market and minimize uncertainty for consumers: policyholders, mortgage holders, taxpayers, the real estate and construction market economies, and insurers and agents. In the recent past, short-term reauthorizations (for fewer than 5 years) have resulted in dislocations and additional costs to those involved in the process because of the near-term prospect that the program might be permitted to expire. Second, we support efforts to move NFIP insurance rates closer to a financially adequate level. The underlying principle necessary to guide those efforts is: insurance rates should cover the full cost of the transfers of risk taking place within the program. To accomplish this goal, rates should cover the expected losses and expenses involved in the insurance transaction and should provide a reasonable additional provision for the risk or uncertainty associated with the coverage being provided. This risk provision means that additional premiums should be collected to cover catastrophic events like Hurricane Katrina, which, although infrequent, may happen in any given year.

The current NFIP rate subsidies do not allow the program to generate premiums that are sufficient to cover average annual losses. Furthermore, the NFIP does not collect additional premium, in excess of the premium sufficient to cover average annual losses and expenses, to allow the NFIP to build up catastrophic reserves, so the NFIP must borrow from the United States Treasury when very large loss events do occur.

Before Hurricane Katrina, the NFIP was generally able to repay its debt with subsequent premiums, because the borrowing had been relatively modest. By contrast, the borrowing that was necessary to cover the losses incurred during Hurricane Katrina resulted in a debt many multiples of what it was before. Thus, much of the current income to NFIP goes to paying interest and some part of the principal for that debt. This leaves much less current income to pay losses, increasing the possibility of further borrowing. At the current rate, it will take decades to repay the existing NFIP debt. Consequently, it is important that any NFIP reform legislation address the debt issue to put the program on sound and sustainable financial footing.

In addition to the above priorities, there are several other issues that we believe should be addressed in any reform legislation:

1. If the NFIP could increase and diversify its pool of policyholders, the financial strength of the program would be improved. Thus, we support efforts to increase participation in the NFIP. It is especially important that the percentage of covered properties subject to riverine flooding be increased. Also, properties outside of the 100-year floodplain, but still subject to flooding, have had significant losses but are not well-represented in the NFIP pool. (Ostensibly, properties outside the 100-year floodplain would have lower rates than those within the 100-year floodplain.) In general, the NFIP's premium base would be increased if more of these types of properties were insured. Increased participation in the program would minimize the impact of adverse selection, in which only the owners of the most exposed properties purchase insurance. Minimizing the impact of adverse selection would help to strengthen the program overall.

2. Repetitive loss properties have been shown to be much more at risk than the average property insured by the NFIP. We recommend Congress address this issue and decide whether these properties should be covered at all and, if so, at what price and under what conditions.

3. Continual attention to the updating of flood hazard maps is needed to better identify properties located within severe flood hazard areas. The Risk Mapping, Assessment and Planning (MAP) program provides digital access and dissemination of new maps. The Risk MAP program is intended to allow maps to be updated in a more timely way. More accurate, up-to-date maps allow a better assessment of hazard. The assessment and reassessment of hazard is vital overall to property liability insurance programs. As the hazard changes, so, too, should the rates and premiums.

This would allow the NFIP to better differentiate rates among policyholders, resulting in more adequate and equitable premiums.

Finally, the National Flood Insurance Program is critical to protecting home and business owners in the U.S. and should be strengthened and extended for a sufficiently longer reauthorization to allow the program to establish a sound financial footing. Steps should be taken to assure that the true costs are accurately apportioned to all property owners at risk. In addition, the current debt should be addressed, so that the program can use its premium income to pay the future losses that will invariably occur.

Thank you for the opportunity to provide this testimony to the Committee.

**LETTER SUBMITTED BY SHANA UDVARDY, DIRECTOR, FLOOD MANAGEMENT POLICY, AMERICAN RIVERS**

American Rivers
Thriving By Nature

June 22, 2011

The Honorable Tim Johnson
Chairman, Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Richard C. Shelby
Ranking Member, Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Johnson and Ranking Member Shelby:

On behalf of American Rivers 65,000 members and supporters across the nation, thank you for holding two hearings on the National Flood Insurance Program (NFIP). American Rivers is the leading conservation organization standing up for healthy rivers so communities can thrive.

For years, American Rivers has been working to protect our "natural defenses" - our wetlands, rivers, floodplains, and upland and coastal areas –to safeguard communities and the environment. We know that communities that allow room for rivers and protect their floodplains are more resilient to the next flood and often recover more quickly from a flood event. Flood events and increased damages will continue to cause damage and fatalities as a result of unwise development in the floodplain, an increasingly volatile climate with more frequent and intense storms, and reduced federal investment in infrastructure. These shifts are likely to have dramatic impacts on communities, threatening public health, weakening economies and decreasing the quality of life in many places.

The NFIP is intended to be one of the Federal government's strongest tools for managing the Nation's flood risk and reducing flood losses by providing flood insurance to over five and a half million Americans. The NFIP not only reduces risk to communities, it also provides guidance on minimum land use and building code standards that help to reduce the loss of natural floodplains that provide beneficial functions like storing flood waters and providing clean water. As our climate changes and as the frequency of extreme flood events increases, the NFIP's role in improving natural defenses will become increasingly more important.

While the NFIP has helped Americans recover from devastating floods for over four decades, it has a number of shortcomings that encourage risky behavior, waste taxpayer money, and make communities more vulnerable to floods. These weaknesses, coupled with natural catastrophes like Hurricane Katrina, have resulted in fiscal insolvency and a debt of $17.8 billion to the Treasury.

FEMA is currently undertaking a "Rethinking the NFIP" effort to address many of these issues. A 2 or 3 year extension of the NFIP may be wise in order to allow Congress time to consider these recommendations. We recommend that any flood insurance legislation include reforms that:

- Eliminate Subsidies and Establish Risk-Based Rates
- Ensure Accurate Flood Maps
- Improve Incentives for Mitigation
- Improve Community Decision Making

**Eliminate Subsidies and Establish Risk-Based Rates**

Nearly a quarter of properties covered under the NFIP pay below-market rates that do not reflect the true risk of flooding to their properties, and as a result encourage homeowners to reside in unsafe areas. Properties that were "grandfathered" into the program at subsidized rates when it was created were expected to gradually decline as new construction with premium rates replaced older properties. However, this has not occurred. Congress should eliminate all subsidies and phase in rates for all properties that are truly risk-based, with a priority on severe repetitive loss properties, repetitive flood claim properties, second homes and vacation homes, and commercial properties. To address concerns with affordability of flood insurance, Congress should opt for an option that assists low-income property owners through an explicit voucher program.

Even rates that aren't explicitly subsidized often underrepresent the risk of flooding in many places. For instance, FEMA uses average historical data to set rates and does not factor in damages from catastrophic loss years, like the destructive hurricane season of 2005. FEMA also does not factor in potential changes in flood risk due to land use changes or climate change. It is critical that FEMA finalize their report on climate change and that Congress consider these findings in revisions to the NFIP.

**Ensure Accurate Flood Maps**

FEMA's Flood Insurance Rate Maps (FIRMs) are a tool used to establish insurance rate zones based on the historical 100 year flood. Properties within the special flood hazard area (SFHA) or the area where there is greater than a 1 percent chance of flooding in a given year are required to purchase flood insurance. FEMA is undergoing Map Modernization (MapMod) and Risk Mapping Assessment and Planning (RiskMAP) Programs to update maps to reflect changes within watersheds, levee certification, and enhanced technology. As a result many citizens are finding themselves in the SFHA when they previously were not.

These changes have and will continue to upset constituents faced with the difficult reality of having to purchase flood insurance. It is important to note that while some property owners are mapped into the SFHA, approximately the same number of property owners is mapped out of the SFHA. Congress should resist the temptation to delay the implementation of flood maps and the mandatory purchase of flood insurance. Delaying implementation perpetuates the false sense of security created by flood maps and levees. In the event of a flood citizens without flood insurance will be much worse off and the federal government could be held responsible. In order to address the financial impact of mandatory purchase, Congress should allow a phase in of premium rates.

Flood maps should be constantly updated and FEMA should continue to improve their technology and use of the best available science. American Rivers supports the redevelopment of a Technical Mapping Advisory Protocol (TMAP) Council to advise FEMA on methods to continue improving flood maps, ensure flood insurance rates are accurate, and communicate impacts of map changes to communities. The TMAP Council should work with FEMA to ensure that the new protocols enhance ongoing MapMod and RiskMAP efforts. The TMAP Council will be critical to providing FEMA with advice on how to incorporate the best available science on future conditions including climate change, increasing development and aging infrastructure into flood maps.

**Improve Incentives for Mitigation**

Often, the most cost-effective way to reduce loss of life and property due to floods is to mitigate before a flood occurs. Mitigation techniques such as buyouts of flood prone properties, creation of greenspace, and restoration of floodplains and wetlands, can remove the threat of flooding to people and property and is a better use of taxpayer dollars than to rebuild homes over and over in the same location. In fact, every dollar FEMA spends on flood mitigation provides up to $5 in benefits. Communities that invest in mitigation experience less severe impacts and recover more quickly, becoming more resilient to the next flood event.

FEMA's Flood Mitigation Assistance (FMA) Program, the Severe Repetitive Loss (SRL) program, and the Repetitive Flood Claims (RFC) program assist communities in mitigation efforts. These programs have helped slow the NFIP's debt, but repetitively flooded properties remain one of the biggest financial drains on the NFIP. According to the GAO, these properties account for only 1 percent of the NFIP's insured properties, but are responsible for 25-30 percent of the claims.

Unfortunately, many communities have been deterred by the statutory requirements of participating in the SRL program. To make FEMA's mitigation programs more streamlined and accessible, Congress should consolidate the RFC and SRL programs under umbrella of the Flood Assistance Program. This will allow FEMA to more effectively work with communities to mitigate flood losses.

**Improve Community Decision Making**

Local governments arguably bear the most important role in floodplain management because they are responsible for making land use decisions and their implementation, while individual property owners are required to bear the financial burden of those decisions through flood insurance and recovery after a flood.

To remedy this paradox, Congress should support FEMA's efforts to develop a community-based flood insurance option. On the most basic level, volunteering communities would opt for a flood insurance policy that covers all properties within a jurisdiction, and the local government would take responsibility for paying the premiums in a manner suitable to the community. Ideally such a program would operate like the Community Rating System to reduce the community's premiums based on the mitigation actions the community undertakes. Congress could support this effort by authorizing FEMA and GAO to undertake studies into the feasibility of such a project as well as giving FEMA authority to pursue community-based flood insurance through a voluntary, pilot program.

In conclusion, thank you for holding hearings on the National Flood Insurance Program. We look forward to working with the Committee to reform the NFIP.

Sincerely,

Shana Udvardy
Director, Flood Management Policy

**LETTER SUBMITTED BY FRANKLIN W. NUTTER, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA**

RAA
REINSURANCE ASSOCIATION OF AMERICA
1445 New York Avenue N.W. 7th Floor Washington, DC 20005
Telephone: (202) 783-8311
Facsimile: (202) 638-0936
http://www.reinsurance.org

June 28, 2011

Chairman Tim Johnson
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Johnson:

The Reinsurance Association of America is pleased to provide comments for the record for the June 23 hearing entitled Reauthorization of the National Flood Insurance Program, Part II. The RAA strongly supports a long term reauthorization of the program that includes substantive reforms. Please find attached a copy of our House testimony that details our positions on some of these key issues. We support the House legislation and believe it will ensure the National Flood Insurance Program (NFIP) can continue to provide needed flood insurance coverage to homeowners living in flood-prone regions, while at the same time protecting U.S. taxpayers.

We would like to bring to the Senate Banking Committee's attention Section 9 – Privatization Initiatives - provisions in the House bill that we would like incorporated into a Senate bill. We believe that the NFIP can address its volatility and extreme event exposure and reduce the dependence of the Program on taxpayers and Federal debt through risk transfer to reinsurance and capital market providers. Both markets have capacity and an appetite to assume flood risk.

The legislation's language makes it clear the FEMA Director has the authority to utilize private reinsurance to minimize the burden on American taxpayers. Importantly, the RAA supports the provision that directs FEMA to assess the capacity of the private reinsurance and capital markets by seeking proposals from those markets to assume a portion of the program's risk, and to submit a report on such assessment six months after enactment. Directing FEMA to seek such proposals will allow NFIP to work with modelers, underwriters and/or brokers to provide the market with an evaluation of its risk portfolio, determine what types of risk in the NFIP are amenable to risk transfer and then if they choose to, find and secure coverage in the private sector.

The process described above would also allow the private sector to evaluate NFIP data and conduct their own risk assessment. Most importantly, this provision helps pave the way for NFIP to transfer catastrophe risk from taxpayers and the Treasury to the private market. Should the NFIP find the bids unattractive on a price or coverage basis, it would not go forward with the placement, and the NFIP would be in the same place it is now: dependant on public debt. If the placements were successful, the private sector would be in a position to provide financial relief to taxpayers.

We applaud your commitment to reforming the NFIP and we urge you to include these provisions that enhance NFIP's ability to explore reducing taxpayer exposure by shifting the risk of loss to the private reinsurance and capital markets. We look forward to working with you on this critical issue.

Sincerely,
Frank Nutter
Franklin W. Nutter
President

**STATEMENT SUBMITTED BY FRANKLIN W. NUTTER, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA**

My name is Frank Nutter and I am President of the Reinsurance Association of America (RAA). The RAA is a national trade association representing reinsurance companies doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. I am pleased to appear before you today to provide the reinsurance industry's perspective on reforms to the National Flood Insurance Program.

Reinsurance is critical to insurers and State-based property insurance programs to manage the cost of natural catastrophe risk. It is a risk management tool for insurance companies to improve their capacity and financial performance, enhance financial security, and reduce financial volatility. Reinsurance is the most efficient capital management tool available to insurers.

Reinsurers have helped the U.S. recover from every major catastrophe over the past century. By way of example, 60 percent of the losses related to the events of September 11, 2001 were absorbed by the global reinsurance industry, and in 2005 61 percent of Hurricanes Katrina, Rita, and Wilma losses were ultimately borne by reinsurers. In 2008, approximately one-third of insured losses from Hurricane Ike and Gustav were reinsured.

The National Flood Insurance Program (NFIP) was established on the fundamentally sound principles of encouraging hazard mitigation and promoting the use of insurance to reduce postevent disaster assistance. However, the NFIP, as it has evolved and been modified by legislative action, compromises, rather than embraces sound public policy, insurance principles and practices. Actions (in whole or in part) to introduce private sector risk assessment into the NFIP, therein retaining the proper role for Government in land-use planning and hazard mitigation, could address those issues and reestablish the flood risk management program as a successful public–private partnership.

In 1973 George Bernstein, the first Federal Insurance and NFIP Administrator, cautioned prophetically: "It is the combination of land-use controls and full actuarial rates for new construction that makes the National Flood Insurance Program an insurance program rather than a reckless and unjustifiable giveaway program that could impose an enormous burden on the vast majority of the Nation's taxpayers without giving them anything in return."

As it currently operates, the NFIP is not an insurance program. But it should be and can be. The fuller application of risk-based rates and an appropriate risk-bearing role for the private reinsurance sector would transform the program. By doing so, the NFIP could also achieve the goal of protecting taxpayers and the Treasury, thereby returning the Program to its original goal of being fiscally sound.

It is a commonly held belief the NFIP is fundamentally bankrupt and a private sector risk bearing role is unachievable. Given the nearly $18 billion dollar debt to Treasury, the Program is demonstrably a millstone on the Federal budget and U.S. taxpayers. The assumption about a private sector risk-bearing role, however, deserves to be considered.

**Protecting Taxpayers With Risk-Based Rates**

Rates in the NFIP that have been subsidized without regard to the present character or ownership of the property should be risk-based. Subsidized rates were introduced early in the Program as an inducement for communities to enter the Program. It was a successful strategy. Nearly 22,000 communities now participate. However, it was the intent of the original legislation that subsidized rates and the properties to which they apply were to be gradually eliminated. In the last 20 years, however, the number of subsidized properties has actually risen by 1.2 million. Additionally, the Program was designed to address primary residences, yet second homes, investment, and vacation properties continue to receive the benefit of subsidized rates.

The Program's subsidies have also facilitated the development of environmentally sensitive coastal areas, including those at high risk to flood losses. The Government Accountability Office (GAO) reports that repetitive loss properties account for 1 percent of policies and 25–30 percent of losses. The Congressional Budget Office (CBO) reports the number of repetitive loss properties has increased by 50 percent in the last decade.

The Congress must also recognize that statutory caps on rates may be popular with its beneficiaries, but the caps distort risk assessment by builders, local officials, property buyers, and NFIP policyholders. They increase the cross subsidy from low or no risk persons and taxpayers to those living in high risk flood areas. The classic "robbing Peter to pay Paul" analogy applies.

According to the GAO, subsidized-rated properties generate 70 percent of the Program's claims. The NFIP and the Congress should address these fundamental flaws in the Program and remove inequitable and unjustifiable rate subsidies. Proposals to provide needs-based subsidies independent of NFIP rates are worthy of support.

**The NFIP Should Plan for Extreme Events**

From 1978 to 2004, the NFIP had a net loss of just $2 billion. CBO reports that if the "early" years, when rates were lower and community participation was not as significant as now, were not included, the Program would have had a profit of $600 million. As a result of losses in 2005—the year the Program had to borrow $20 billion from Treasury—debt service of 30 percent of premiums collected is built into the NFIP's finances. With the addition of a contingency plan for extreme event years and without this financing load, the Program can be fiscally sound.

FEMA represents that 75 percent of its policies are "actuarially" sound. Sound insurance pricing would reject this representation because the NFIP does not incorporate a catastrophe factor for infrequent, yet severe, loss years. The Program unfortunately takes into account only 1 percent of the losses from the 2005 program year (Hurricanes Katrina, Wilma, and Rita) and relies on the "average annual loss" model for its pricing. This ignores the fact that extreme event catastrophes must be financed. FEMA's average annual loss (FEMA presumes $1.3 billion) pales in comparison to actual insured and reinsured loss costs in recent natural catastrophes. This average annual loss pricing model is ill-suited for natural catastrophe risk—whether it be in the private or public sector.

Because of the pricing model, the NFIP has neither adequately planned, nor priced for, extreme event(s) years. As a result, the GAO recently concluded the Program does not have a viable funding model to repay the existing debt to Treasury. No private sector solution is available for this existing debt. However, as the GAO points out, the Program should operate like an insurance entity. If it did, it could reduce or eliminate taxpayer exposure to future debt by laying off risk to the private sector through reinsurance and catastrophe bonds. As the GAO admonished,

> Private insurers typically retain only part of the risk that they accept from policyholders, ceding a portion of the risk to reinsurers (insurance for insurers). This mechanism is particularly important in the case of insurance for catastrophic events, because the availability of reinsurance allows an insurer to limit the possibility that it will experience losses beyond its ability to pay. NFIP's lack of reinsurance, combined with the lack of structure to build a capital surplus, transfers much of the financial risk of flooding to Treasury and ultimately the taxpayer.

**The Private Sector Role in the Program**

In recent years, the private insurance sector has worked in partnership with FEMA through the Write Your Own program (WYO). This role for insurers has provided the NFIP with a valuable marketing arm and administrative capability that minimizes the need for a Federal bureaucracy to issue policies and adjust claims.

A private insurance market for flood risk has not developed. Insurers are concerned about State rate regulatory manipulation and suppression and adverse selection of risk. Historic rate subsidies by the NFIP make a traditional private market flood insurance product for homeowners noncompetitive. Without a viable private insurance market, the NFIP cannot be terminated or put into run-off in the short term.

Yet, there have been positive developments in recent years: (1) recognizing there are significant concerns about map integrity, the NFIP has established a map program for all communities participating in the NFIP; (2) catastrophe modeling firms, as well as some reinsurance brokers and underwriters, now provide flood models for underwriting purposes in the U.S. and in other countries; (3) there has been growth in private sector flood mapping entities; (4) twenty-two universities now have flood research programs; and (5) satellite imaging has improved risk assessment.

We believe a private reinsurance risk bearing role for the NFIP can be established, with the following conditions: (1) preserve the WYO program; (2) retain the current Federal risk bearing role; (3) introduce the risk analysis and risk spreading role of the private reinsurance and capital markets; (4) utilize the existing statutory framework; and (5) consult with knowledgeable public and private interests about long-term approaches to the development of a greater private sector flood insurance market.

**The Role of Reinsurance: Two Complementary Options**

We believe the NFIP can address its volatility and extreme event exposure and reduce the dependence of the Program on taxpayers and Federal debt through risk transfer to reinsurance and private market capital providers. The NFIP could also seek the placement of catastrophe bonds to augment reinsurance. Both financial sectors have significant capacity and believe flood risk can be reinsured or transferred into capital markets. Utilizing private reinsurance or catastrophe bond risk transfer mechanisms also introduces a private sector rating verification model into the NFIP—thus providing an incentive and guidepost for risk-based rates.

*Transactional Reinsurance:* As with most State property insurance plans, and nearly all private insurers, the NFIP could address its volatility and extreme event problem through the purchase of reinsurance from private market capital providers. Additionally, where appropriate, NFIP could seek the placement of catastrophe bonds to supplement reinsurance capacity. Both markets have significant capacity and an appetite to take flood risk. These sectors believe flood risk can be reinsured or transferred into capital markets if properly structured. As with other governmental insurance entities and private sector insurers, the NFIP would work with modelers, underwriters, and/or brokers to provide the market with an evaluation of its risk portfolio, determine what types of risk (by geography, insured exposure, or category of risk) are amenable to risk transfer and then seek coverage in the private sector. This would allow these entities to evaluate the NFIP data and introduce their own risk assessment into the process. Like any catastrophe reinsurance and "cat" bond program, it would transfer catastrophe risk from taxpayers and the Treasury to the capital markets. Should the NFIP find the bids unattractive on a price or coverage basis, it would not go forward with the placement. The NFIP would, therefore, be in the same place as it is now: dependent on public debt. If the placement were successful, the private sector would provide financial relief to taxpayers. No study is necessary to evaluate this approach as the market and NFIP officials can pursue it at this time with the full opportunity to evaluate coverage proposals without prior commitment.

*Reinsurance Pool*: Section 4011 of the NFIP legislation adopted in 1968 provides for the Director of FEMA (at the time HUD) to "encourage and arrange for appropriate financial participation and risk sharing . . . by insurance companies and other insurers." Section 4051 provides that the Director is authorized "to assist insurers to form, associate or join in a pool" on a voluntary basis 'for the purpose of assuming on such terms . . . as may be agreed upon, such financial responsibility as will enable such insurers, with the Federal financial assistance' to assume a reasonable proportion of responsibility for the adjustment and payment of claims for losses under the flood insurance program." Such a pool of insurers did in fact operate as the National Flood Insurers Association from 1968 to 1978, as the administrative arm of the Program and with a risk-bearing role through a formula negotiated with the Government. Section 4052 authorizes the Director to enter into agreements with the pool to address risk capital, participation in premiums and losses realized, and operating costs. Section 4055 authorizes the Director to enter into a reinsurance relationship with the pool to address losses in excess of those assumed by the pool.

The provisions of the statute authorizing the pool, created in conjunction with the adoption of the Act, have long been dormant. Yet they remain a viable mechanism for the creation of another pool. This time it would be to reinsure the NFIP—capitalized by those insurers that voluntarily wish to provide capacity. By doing so, these insurers would have access to the NFIP's flood insurance coverage and underwriting data. The Director and those participating insurers would enter into negotiations over the risk-sharing formula and could individually subscribe capacity on an annual basis. As with the traditional reinsurance proposal noted above, FEMA would work with modelers, underwriters, and brokers to assess its risk portfolio. Such collaboration would determine what types of risk are appropriate, what method of reinsurance the pool would offer to the NFIP, as well as what type of reinsurance, if any, FEMA would provide to the pool. As with the prior suggestion of laying-off risk through traditional catastrophe reinsurance placement, this proposal does not change the WYO program. FEMA remains the insurer of flood risk at the consumer level, transfers flood risk from taxpayers to the private sector and allows those insurers that wish to participate in the risk to do so through a standing facility.

These two approaches, a traditional property catastrophe program and the reauthorization of a standing reinsurance facility or pool, are both complementary and yet not exclusive to each other. The existing statutory authority may well be sufficient to move forward without delay, on either or both.

The RAA looks forward to working with Members of this Committee, the Congress, FEMA, and officials from the NFIP to explore and pursue private sector reinsurance and capital market options.

---

## STATEMENT SUBMITTED BY THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

The National Association of Mutual Insurance Companies is pleased to offer comments to the United States Senate Committee on Banking, Housing, and Urban Affairs on the National Flood Insurance Program (NFIP).

NAMIC believes that there are significant problems with the NFIP as it is currently structured and the best solution involves reforming and optimizing the program. The views we share with the Committee are based on the perspective of over 1,400 NAMIC members.

Founded in 1895, the National Association of Mutual Insurance Companies (NAMIC) is the largest and most diverse property/casualty insurance trade association in the United States. Its 1,400 member companies write all lines of property/casualty insurance business and include small, single-State, regional, and national carriers accounting for 50 percent of the automobile/homeowners market and 31 percent of the business insurance market. We also have over a quarter of the companies that participate in the NFIP's "Write-Your-Own" program as members. NAMIC's membership truly represents a cross-section of the industry and has been proudly protecting its policyholders throughout North America for many years.

### The Nature of Flood Risk

Insurance markets function best when certain conditions are met. For example individual exposures should be independent of each other (*i.e.*, not correlated) and there should be a large number of individual risk exposures to allow the use of statistical predictions of future losses. Losses should be accidental or unintentional in nature and should be generally predictable, allowing insurers to set premiums properly. Insurers must be able to spread risk over a large enough pool and each insured must pay the cost of adding to the risk pool.

For some risks, however, private insurance markets are unable to provide sufficient coverage. Certain risks are uninsurable because they defy the conditions private markets require for operation. Flood risk is one of these unconventional risks. Adverse selection prompts only those who believe they are at risk of flooding to purchase insurance limiting the ability to properly pool risk. Flooding is extremely devastating and markets face serious problems providing coverage for these truly large and costly events. The fact that flooding involves a risk that is highly concentrated and correlated makes flood loss especially difficult to insure. In most lines of insurance (*e.g.,* life, auto, fire insurance), the total amount in premiums collected and the total amount paid in claims are almost continuously in balance because claim costs for any given year are relatively predictable. This is not the case with flood risk, which by nature tends to result in losses that are very low in some years and extremely high in other years. Additionally, unlike other traditional threats to property, flooding has historically been spatially confined and generally limited to specific geographic locations complicating an insurer's ability to widely spread the risk. Compensating for these challenges requires insurers to charge high premiums to cover the sizable cost of capital that they must hold in reserve to ensure they are able to pay all the claims that will be filed in high-loss years.

The nature of flood risk and the factors that affect its insurability are a recipe for adverse selection, whereby the only people willing to buy insurance are those with the highest levels of risk. Thus the insurers flood portfolio consists solely of these high-risk individuals. Properly priced insurance (which takes into account the amount of surplus needed to pay claims in high-loss years) would be regarded by most potential purchasers as a "bad buy"—property owners who perceive that there is little likelihood they will experience loss due to flooding will conclude that the cost of purchasing insurance is not worth it. Consequently, the only people who would be interested in purchasing flood insurance would be those most likely to suffer a significant flood-related loss, and the cost to insurers of providing coverage for these properties would cause premiums to rise to unaffordable levels. Simply put, the nature of flood risk makes it virtually impossible to pool risk among a large enough population for private insurers to be able to offer a viable and affordable insurance product.

### The National Flood Insurance Program

Prior to the creation of the NFIP, flood losses were dealt with in a simple and direct fashion by the Federal Government. As noted in a 2002 report by the Federal

Emergency Management Agency, “major riverine flood disasters of the 1920s and 1930s led to considerable Federal involvement in protecting life and property from flooding through the use of structural flood-control projects, such as dams and levees, with the passage of the Flood Control Act of 1936.”

These projects proved to be a costly and generally ineffective solution. Despite billions spent by the Federal Government on flood control projects during that time the report noted that “the losses to life and property and the amount of assistance to disaster victims from floods continued to increase.” Furthermore, the only assistance available to flood victims at that time was direct Federal disaster aid, which also contributed to the high costs of a major flooding catastrophe. Congress began considering the potential for a national flood insurance mechanism as early as the 1950s, but quickly realized that the private market simply could not underwrite the highly concentrated and correlated risk of massive floods. In 1968, the Federal Government stepped in to create the NFIP to mitigate the exposure both to taxpayers as well as citizens in flood-prone areas. Congress sought to address the increasing costs of taxpayer-funded disaster relief by using premium dollars taken in every year to pay out any flood losses incurred by policyholders for the same year.

Originally, the only way property owners could purchase NFIP coverage was through specialized insurance agents. To increase take-up rates and streamline the claim handling process, the NFIP in 1983 created a “public–private” partnership with private insurers known as the Write-Your-Own (WYO) program. The program utilizes private insurers to market, sell, and administer the Standard Flood Insurance Policy. These companies—WYO carriers—use their own agents and letterhead and deal directly with the policyholders while the Federal Government retains responsibility for underwriting losses. Over 90 percent of all flood policies are written through WYO companies. The partnership has proven very successful in facilitating the prompt settlement of claims, even when faced with a very large volume of claims following extreme flooding events.

For example, as of May 2006, more than 95 percent of the 162,000 claims for flood damage caused by the 2005 Gulf and Atlantic Coast hurricanes had been settled by the WYO companies.

Over the last 40 years, the NFIP has allowed millions of Americans to avoid serious financial losses brought about by disastrous flooding, and as of today, the program had more than 5.6 million policies in force. However, the NFIP has many flaws in its design and execution and is need of serious reform in order to maintain a sound financial footing and better protect the American taxpayer. Subsidized premiums have been charged on a nonactuarial basis; development has increased the amount and value of property exposed to flood risk; take-up rates for those in need of coverage remain extremely low (under 30 percent of those that need flood insurance purchase it); and the recent severity of flood losses has demonstrated that the NFIP is not constructed to handle major catastrophic events. Although virtually self-sustaining for the 25 years prior, in 2005 the program incurred over $20 billion in debt, and currently carries $17.75 billion in debt.

**Optimization of the NFIP**

Under the current circumstances, it is not surprising that policy makers would raise questions about the future direction of the NFIP. Clearly the *status quo* is unacceptable. However, we urge caution to those who think we can do away with the program entirely. Nothing about the realities of flood risk has fundamentally changed and primary insurers are still unable to offer this coverage. The presence of a Federal program is just as important today as it was 40 years ago. The phenomenon that led to the creation of the NFIP—the absence of a viable private flood insurance market—remains the fundamental problem, and there is no reason to believe that dismantling the NFIP would suddenly cause a private market to materialize.

The NFIP fulfills an important role, and with the right mix of reforms, the program can begin to address the problems of adverse selection, moral hazard, and financial instability that have plagued it in the past. Therefore we believe that the best and most viable option is optimization—maintaining the current NFIP framework while implementing reforms that address existing weaknesses.

First and foremost, the program must be reauthorized for the long term. Constant reauthorization debates create uncertainty and can lead to lapses in the program as we saw in 2010. During these lapses, companies were not permitted to write new policies, issue increased coverage on existing policies, or issue renewal policies, and lenders and home buyers were prevented from closing on mortgage loan contracts. The NFIP should be reauthorized for an extended period in order to bring stability to the program and instill confidence among consumers.

In addition to long term reauthorization we recommend a package of key reforms designed to achieve five essential objectives:

1. Charge Actuarially Sound Rates and Eliminate Subsidies
2. Update and Improve the Accuracy of Flood Maps
3. Increase Take-Up Rates
4. Discourage Repetitive Loss Properties
5. Improve Management and Correct Operational Inefficiencies

*Charge Actuarially Sound Rates and Eliminate Subsidies*

Inadequate rates that do not reflect the actual costs of living in a flood-prone area are the source of many of the NFIP's problems. In the original NFIP legislation, Congress tasked FEMA with setting rates to meet the "objective of making flood insurance available where necessary at reasonable rates so as to encourage prospective insureds to purchase such insurance." The program was structured to subsidize the cost of flood insurance for existing homes, while charging actuarially sound rates for newly constructed properties built after the introduction of flood insurance rate maps. It has been estimated that, on average, the premiums charged for these older properties are 60 percent less than the amount that would be considered actuarially sound.

Moreover, it is doubtful that the rates charged for properties built after the advent of flood maps comport with most private insurers' conception of "actuarially sound." The price for NFIP flood insurance is relatively low—on average nationwide, property owners pay only $2.64 per $1,000 of flood coverage, or $528 per year for $200,000 in coverage. This average is constant across all States, including highly flood-prone States, which sustained major flood losses during the 2004, 2005, and 2008 hurricane seasons. Insofar as these rates do not reflect the true cost of providing coverage, the NFIP bears less resemblance to insurance than to a targeted public spending or risk-management program.

Just as inadequate rates fail to reflect the true cost of providing coverage, they also fail to reflect the actual risks of living in a flood-prone area. This has the effect of encouraging poor land use and development in high-risk areas, thereby increasing the total potential losses that will be incurred in the event of a flood. During the 40-plus years that the NFIP has been in place, there has been a large population increase in flood-prone coastal States, which now account for a very large portion of the NFIP portfolio. In Florida, for example, the population has increased from 6.8 million in 1970 to nearly 18.5 million in 2009. During the same period, there was a sevenfold increase in the number of NFIP flood policies in force and now more than two-thirds of NFIP policies are located in just five coastal States.

An updated rating system should include the following:

- Elimination of subsidized rates (implicit as well as explicit);
- Immediate institution of risk-based rates for nonprimary residences, repetitive loss properties, and business properties;
- Tiered structure that reflects differences in risk based on updated maps;
- All new policies should charge actuarially sound, risk-based rates;
- Under certain circumstances, areas significantly impacted by changes in mapping could be eligible for phase-ins of actuarial rates;
- Once risk-based rates are in place, credits should be given for mitigation efforts.

The NFIP must begin charging risk-based rates if it is to have any chance of being a solvent program; under the current structure there is no chance that the program will ever repay the debt it accumulated in 2005. However, the move to actuarially sound rates is likely to be painful due to the higher premiums that will have to be charged in many instances. For those property owners who need assistance, flood vouchers might be offered on a means-tested basis to help mitigate the costs. Any subsidies that the Government believes are necessary must be independent of the NFIP and fully transparent. Subsidies cannot continue to be hidden within the insurance mechanism, and homeowners should be fully aware of the real risks of where they live.

*Update and Improve the Accuracy of Flood Maps*

Flood maps must be updated based on the best available science, with the goal of ensuring that NFIP flood maps accurately reflect the risks caused by flooding. Increasing and maintaining the accuracy of flood maps is essential to the operation of an effective flood insurance program. The power of newer technologies must be harnessed to provide program officials and property owners, as well as rescue workers and land development officials, with the most accurate information possible.

The availability of new technology has given FEMA the ability to better evaluate flood exposure in every region of the country, but the more accurate maps made possible by this technology will inevitably raise protests from residents who are suddenly informed that their home is located in a floodplain. Not only will they face the prospect of having to purchase flood insurance (which may be expensive assuming actuarial rates are charged), but some evidence suggests that homes designated as being in a floodplain suffer a loss in value. Elected officials will likely face pressure from constituents and interest groups to postpone the starting date of the new maps or to attack their credibility.

These considerations have led NAMIC to endorse a new mapping protocol developed by the SmarterSafer coalition,[1] of which NAMIC is an active member. The coalition's proposal contains the following elements:

- Establishment of a council to develop updated and accurate flood maps. This new body—the Technical Mapping Advisory Protocol (TMAP) Council—could be composed of the following members:
  - Federal Emergency Management Agency
  - U.S. Geological Survey
  - Department of the Interior
  - National Oceanic and Atmospheric Administration
  - A data management expert
  - U.S. Army Corps of Engineers
  - A flood/stormwater management representative
  - Department of Agriculture's Natural Resources Conservation Services
  - A State emergency management representative
  - U.S. Fish and Wildlife Service
  - National Marine Fisheries Service
  - A recognized professional surveying association or organization
  - A recognized professional mapping association or organization
  - A recognized professional engineering association or organization
  - A recognized professional association or organization representing flood hazard determination firms;
- The TMAP Council should have a balance of State, local, Federal, and private members.
- The Council should consult with stakeholders through at least four public meetings annually, and seek input of all stakeholder interests including:
  - State and local representatives
  - Environmental and conservation groups
  - Insurance industry representatives
  - Advocacy groups
  - Planning organizations
  - Mapping organizations
- Within 1 year, the TMAP Council should propose new mapping standards that ensure the following:
  - Maps reflect true risk, including graduated risk that better reflects risk to each property. This does not need to be at the property level, but should be at the smallest geographic level possible—whole communities should not be mapped together without taking into account different risk levels.
  - Maps reflect current land use and topography and incorporate the most current and accurate ground elevation data.
  - Determination of a methodology for ensuring that decertified levees and other protections are included in maps and their corresponding flood zone reflect the level of protection they confer.
  - Maps take into account best scientific data and potential future conditions (including projections for sea-level rise).
- TMAP should continuously function, reviewing the mapping protocols, and making recommendations to FEMA when they should be altered.

[1] Smarter Safer Coalition Flood Proposal, February 22, 2011. *www.SmarterSafer.org*

- Within 6 months of TMAP recommending new mapping protocols, FEMA should begin updating maps based on the recommendations.
- Within 5 years from the implementation of the mapping protocols, all flood maps should be updated according to the new protocol.
- NAMIC believes the TMAP process would facilitate development and adoption of accurate maps. Speedy adoption of these updated flood maps is essential to ensure that the individuals and businesses in flood-prone areas can get the protection they need and we owe these people and the American taxpayer no less.

Mapping technology has significantly improved since the 1970s. Putting off the adoption of updated flood maps does a disservice to those citizens living in flood-prone areas who in the end, risk losing their homes and their lives.

*Increase Take-Up Rates*

Insurance is inherently dependent on the "law of large numbers," thus the insurance mechanism works best when everyone participates in the program. Currently only 20 to 30 percent of individuals exposed to flood hazards actually purchase flood insurance. To make matters worse, many of those who purchase flood insurance do so only after suffering damage from a flood, then allow their policies to lapse after several years have passed during which they experienced no flood loss. The program must take steps to address this adverse selection and increase these numbers dramatically in order to properly pool the flood risk and achieve financial soundness. There are several possible ways to improve these take-up rates:

- Stiffer penalties could be imposed on financial institutions that either fail to require flood insurance coverage for mortgages on properties in flood-prone areas, or allow the policies to lapse. Although owners of properties located in special flood hazard areas are required to purchase and maintain flood coverage as a condition of obtaining a federally backed mortgage, experience suggests that enforcement of this rule is spotty at best. For example, following a Vermont flood in 1998, FEMA discovered that of the 1,549 homes that were damaged by the flood, 84 percent lacked flood insurance, even though 45 percent were required to have flood coverage in place. Apparently mortgage lenders had done little to ensure that the mandatory flood insurance purchase requirement was met.
  - Require homeowners in flood-prone areas to sign a "Disaster Relief Waiver" stipulating that they forfeit their right to disaster relief in the event they choose not to purchase flood insurance. This requirement should apply to all homeowners, not just those with federally backed mortgages, and would serve to disabuse property owners of the expectation that generous Federal disaster relief will be available to flood victims and therefore they need not purchase flood insurance.
  - The NFIP should be given a renewed mandate to improve and expand its public education programs to ensure that more people are made aware of the program and the benefits of having flood insurance coverage to protect their properties.

*Discourage Repetitive Loss Properties*

A recent Congressional Budget Office study revealed that there are currently about 71,000 NFIP-insured "repetitive loss properties," which represent just 1.2 percent of the NFIP portfolio but account for 16 percent of the total claims paid between 1978 and 2008. Moreover, roughly 10 percent of these repetitive loss properties have received cumulative flood insurance claim payments that exceed the value of the home. American taxpayers should not be forced to subsidize a small subset of NFIP policyholders who continue to rebuild in high-risk areas.

A reformed NFIP would include a system to ensure repetitive loss properties are not a drain on the program. Options to achieve this goal include:

- A buyout program. A prioritized list of properties for buy out—those that have had the largest payouts from the program—could be created and purchase offers made. If a reasonable buyout offer is made (based on appraisals) and a repetitive loss property owner refuses, that property could be prohibited from purchasing flood insurance through the NFIP.
- Make owners of repetitive loss properties ineligible for NFIP coverage if they choose to rebuild in the same place following a loss from a flood.
- Make owners of repetitive loss properties ineligible for disaster relief.

*Improve Management and Correct Operational Inefficiencies*

The GAO's report [2] on at-risk Federal operations highlighted the deficiencies in FEMA's data tracking capabilities. The report found that FEMA lacks clear procedures for monitoring contracts and claims records, despite the investment of $40 million over 7 years for new systems. FEMA needs to be held accountable for both establishing and executing these procedures so the program can better monitor the flood situation. One of NAMIC's recommendations to improve take-up rates is a stronger enforcement of mandatory purchase and maintenance of flood insurance requirements by mortgage lenders. While lenders must take steps to ensure greater compliance, responsibility lies with the NFIP for monitoring policy data and coordinating enforcement with the lenders. To achieve this goal, FEMA must develop and institute clear procedures for monitoring contracts and claims records, effectively communicating with lenders and triggering enforcement actions for noncompliance.

**NAMIC's Views on the COASTAL Act**

Finally, NAMIC would also like to take this opportunity to comment on S. 1091, the Consumer Option for an Alternative System to Allocate Losses (COASTAL) Act, sponsored by Senator Roger Wicker. We believe Senator Wicker has taken a constructive approach to a very complex issue, and we appreciate his hard work. We share the objective of expediting the claims resolution process for customers where allocation of loss between wind and water is indeterminate. These cases sometimes lead to coverage disputes, resulting in litigation between policyholders and insurers that can take up to 2 years to decide in court. This delay in claim resolution and payment is burdensome and unfair to all parties concerned.

Notwithstanding its laudable intent, we fear that this plan could cause more confusion for insurers and consumers in the aftermath of a major natural disaster. Most claims are settled in a matter of days or weeks. For the vast majority of policyholders, waiting 90 days for a determination would significantly slow the claims payment process. More specifically, the following are four areas where we would seek to amend or clarify.

*New Federal Authority Over State Regulated Insurers*

The loss allocation plan raises the specter of a greater intrusion by the Federal Government into the private insurance market. Under the COASTAL Act, for the first time a Federal agency would be telling State-regulated property/casualty insurance companies what they have to pay in claims. We strongly believe that State insurance commissioners should be involved in the loss allocation process. At the very least, State commissioners should have a seat on the arbitration panel.

*Technical Questions on the Standardized Loss Allocation Model*

The COASTAL Act establishes a mechanism called the "Standardized Loss Allocation" (SLA) model that will purportedly utilize the most scientifically valid determinations of wind and water loss for insured coastal properties, in cases where only a foundation, or "slab," remains of the original property. The model is developed by the National Oceanic and Atmospheric Administration (NOAA), and is required to be 90 percent accurate for each individual property that is subject to the SLA system for allocating losses. If the SLA model is less than 90 percent accurate, it will not be used to allocate losses and claim disputes could then move to litigation, as happened in several Gulf Coast States after the 2005 Hurricane Season.

While NOAA may have a sufficient number of weather sensors in hurricane-prone areas, experience has shown that strong storms, which cause the greatest number of indeterminate losses, are likely to damage the NOAA sensors relied upon for this model, causing the sensors to fail. In this scenario, the NOAA model would not reach 90 percent accuracy and the affected policyholders and insurers would receive no more clarity than they have today. Ironically, the low-probability, high-impact events whose aftermath the model is intended to address are precisely those for which it will probably be rendered useless.

We also are concerned that the model may be overly reliant on NOAA while disregarding credible private sector resources for this type of loss analysis. For example, specialized engineering and scientific firms also offer baseline damage surveys, topographic surveys, and meteorological analysis of such total loss properties. Such additional input into the model would ease our concerns about NOAA's potential limitations. If not added to the NOAA model, independent causation analysis should be admissible in the appeal arbitration process.

---

[2] Government Accountability Office; GAO-11-278 High-Risk Series. An Update, pp. 167–170.

*Voluntary Participation in the Loss Allocation Model*

NAMIC appreciates the intent by Senator Wicker to make participation in the SLA system voluntary for all non-Write Your Own (WYO) insurers. However, as the bill is written, this provision appears somewhat vague. Additional language clarifying the category of insurers for whom participation will be truly voluntary would be appreciated.

Furthermore, we believe this model could create an unstable business environment for the Write Your Own carriers and thus force their exit from the WYO marketplace. While we are unable to substantiate such claims before implementation, concerns remain over the civil liabilities provision and the lack of preemption from "bad faith" lawsuits. WYO carriers may very well determine that the number of "slab" claims that would trigger use of the model is not great enough to cause real concern. The true market signal will come in response to implementation of the COASTAL Act. As such, a pilot program that includes full implementation throughout the United States with a sunset provision requiring reauthorization may be a prudent move by Congress.

*Limitations on Private Claims Adjusting*

NAMIC is concerned about limitations placed on the private insurance adjuster's role in the indeterminate loss allocation process. We appreciate that the bill allows private insurance adjusters to participate in the process by determining "slab-only" cases and contributing additional pertinent property-loss data to the NOAA storm model. However, after the "slab" determination and data entry, the adjuster must then cede decision-making authority and defer to NOAA's "standard formula" as a tool to settle the claim. Aside from our questions about the SLA model's accuracy, forfeiting control by private insurers to the Federal Government creates a disconcerting precedent.

It will be imperative that the appeals through the five-member arbitration panel include consideration of the private insurers' findings, both from their adjusters and from independent causation analysis professionals.

Finally, the bill also appears to invite lawsuits against adjusters for their determinations of "slab" properties, which we believe sets another dangerous precedent that could potentially cause WYO carriers to leave the WYO program. By the same token, it could deter adjusters from handling flood claims, especially "slab" cases. The ensuing reduction in the number of certified adjusters handling such claims may, in turn, result in delays in NFIP claim adjustment.

*Scope of the Standardized Loss Allocation Process*

As we understand the current draft of the bill, the Standardized Loss Allocation process established by the COASTAL Act would apply only to indeterminate loss claims where both private wind coverage and NFIP flood coverage are in place; it would not apply in cases where the affected property was not covered by flood insurance. However, some proponents of the bill have suggested that it would apply as well in cases where no flood coverage is in place. We trust that this interpretation is incorrect, but the fact that there is evidently some confusion on this point indicates that clarifying language should be added to the bill.

*Summary of COASTAL Act Viewpoint*

There is no doubt that insurers and policyholders alike would benefit from the creation of a fair and efficient method for allocating indeterminate losses that obviates the need for costly and time-consuming litigation. On the other hand, neither insurers nor coastal property owners will benefit from a new system that ultimately limits access to, and affordability of, homeowners insurance. We share Senator Wicker's goal of ensuring timely and fair claims payments to victims of natural disasters. NAMIC looks forward to working closely with Senator Wicker and his colleagues to ensure that the measure will succeed in achieving positive results for insurers and policyholders while avoiding potential negative consequences.

**Conclusion**

The NFIP is in need of significant reforms in order to continue providing flood protection to those who need it. As a practical matter, there is no private residential market for flood insurance and efforts to create one will continue to be frustrated by rate regulation, adverse selection, and capital constraints. However, other proposals that seek to explore a risk-bearing role for the private sector in the NFIP may have merit and should be given due consideration. For example, ceding a portion of the NFIP's risk to the private sector through reinsurance and catastrophe bonds could reduce taxpayer exposure to future debt.

In sum, the objective of any reform legislation should be to maintain and optimize the current flood insurance program. We believe that optimization is the best way to balance the many goals of the reform effort: fiscal soundness, affordability of insurance, adequate coverage for those at risk, floodplain management (reduction of flood hazard vulnerability), economic development, individual freedom, and environmental protection.

NAMIC thanks the Committee for its consideration of National Flood Insurance Program reform. We hope that current legislative proposals will incorporate NAMIC's five fundamental objectives outlined in this testimony. We look forward to working with the Committee on these and further suggestions for ways that the current structure can be maintained and optimized.

## STATEMENT SUBMITTED BY THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

The Independent Insurance Agents and Brokers of America, also known as the Big "I", is grateful for the opportunity to submit testimony to the U.S. Senate Committee on Banking regarding the reauthorization of the National Flood Insurance Program (NFIP). The Big "I" is the Nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance—property/casualty, life, health, employee benefit plans, and retirement products. In fact, our members sell 80 percent of the commercial property/casualty market. It is from this unique vantage point that we understand the capabilities and challenges of the insurance market when it comes to insuring against flood risks.

### Background

The Big "I" believes that the NFIP provides a vital service to people and places that have been hit by a natural disaster. The private insurance industry has been, and continues to be, largely unable to underwrite flood insurance because of the catastrophic nature of these losses. Therefore, the NFIP is virtually the only way for people to protect against the loss of their home or business due to flood damage. Prior to the introduction of the program in 1968, the Federal Government spent increasing sums of money on disaster assistance to flood victims. Since then, the NFIP has saved disaster assistance money and provided a more reliable system of payments for people whose properties have suffered flood damage. It is also important to note that for almost two decades, up until the 2005 hurricane season, no taxpayer money had been used to support the NFIP; rather, the NFIP was able to support itself using the funds from the premiums it collected every year.

Under the NFIP, independent agents play a vital role in the delivery of the product through the Write Your Own (WYO) system. Independent agents serve as the sales force of the NFIP and the conduits between the NFIP, the WYO companies, and consumers. This relationship provides independent agents with a unique perspective on the issues surrounding flood insurance, yet also makes the role of the insurance agent in the delivery process of flood insurance an incredibly complex endeavor. Agents must possess a high degree of training and expertise and must regularly update their continuing education credits through flood conferences and seminars. Every agent assumes these responsibilities voluntarily and does so as part of being a professional representative of the NFIP.

Despite our strong support of the NFIP, we also recognize that the program is far from perfect, which was made all the more clear by the devastating 2005 hurricane season. The current $18.3 billion dollar debt, incurred in 2005, reveals some of the deficiencies of the program and has strained Government resources. It is important that Congress shore up the NFIP's financial foundation and use this opportunity to enact needed reforms to ensure the long-term sustainability of the program.

For this reason, the Big "I" strongly supports both reauthorizing and reforming the NFIP.

### Long Term Extension

As you know, the NFIP is a Congressionally authorized program that requires periodic extensions. Traditionally these extensions have been for multiple years (often for 5-year periods) but in recent years Congress has not passed a long-term extension of the program and instead has opted to pass numerous short-term extensions. Last year alone the NFIP expired three separate occasions only to be retroactively extended by Congress each time. Each expiration of the program led to concrete damage to the real estate market and the country's economy. During one month-long expiration in June 2010, for example, the National Association of Realtors estimated that as many as 50,000 new home loans were either significantly delayed or canceled. While the IIABA appreciates each of the retroactive extensions, we strongly believe that in order to provide certainty to the marketplace as well as avoid damage to our fragile economy, Congress should pass a long term extension.

Even the short term extensions passed over the last several years, while thankfully staving off expiration of the program, caused their own economic damages. Every time the program is set to expire, WYO companies send notices to their consumers about the pending expiration, agents must then communicate to their clients about what the ramifications of an expiration would be (as well as oftentimes providing real time legislative updates on extension legislation), banks must prepare for how and if to enforce the mandatory purchase requirement of an expired program, and Realtors and mortgage bankers must discuss with their customers how and if to proceed with home loan closings. While not nearly as damaging as an actual expiration, the uncertainty and the increased work-load caused by short term extensions justifies a long term extension of this critical program.

It is for these reasons that IIABA strongly urges the Senate to include a 5-year extension in any NFIP reform legislation.

**Flood Insurance Reform and Modernization Act of 2007**

As you know, the Senate in May of 2008 passed the Flood Insurance Reform and Modernization (FIRM) Act of 2007 by an overwhelming vote of 92–6. The Big "I" strongly supported this legislation and urges the Committee to use its text as a starting point for writing a reform and reauthorization bill in this Congress. In addition to a 5-year extension, the 2007 Senate FIRM Act included common sense reforms to the program that were intended to put it on the path towards financial sustainability. Some of these common sense reforms strongly supported by the Big "I" include the phasing out of many subsidies and the increase in the elasticity band for annual premium increases.

The Big "I" has for many years asked Congress to explore phasing out subsidies in the NFIP altogether and strongly supports these provisions found in the 2007 Senate FIRM Act. Almost 25 percent of property owners participating in the NFIP pay subsidized premium rates. These subsidies allow policyholders with structures that were built before floodplain management regulations were established in their communities to pay premiums that represent about 35 to 40 percent of the actual risk premium. The subsidized rates were deliberately created by Congress in 1968 in order to help property owners during the transition to full-risk rates. However, after 43 years the Big "I" believes it is time to start phasing out this significant subsidization.

In addition to the fact that subsidized rates torpedo any hope that the NFIP could ever be actuarially sound, FEMA estimates that subsidized properties experience as much as five times more flood damage than structures that are charged full-risk rates. Customers that are paying a full actuarial rate have a vested interest to take measures to reduce the economic damages associated with floods. In contrast, those with subsidized rates have less incentive to mitigate. The Big "I" supports phasing out subsidies for commercial buildings, second and vacation homes, homes experiencing significant damage or improvements, repetitive loss properties, and homes sold to new owners.

The Big "I" also strongly supported the Senate's proposal to increase the "elasticity band" with which FEMA can increase premiums in any given year. Currently the annual elasticity band for premium increases is a maximum of 10 percent on any property. The legislation would have proposed to increase this band to 15 percent, which will hopefully allow the program to move even more properties towards actuarially priced rates. The Big "I" hopes that any new reform legislation will include both the removal of many of these subsidies and the increase in the elasticity band for premium adjustments.

**Additional Recommendations**

The Big "I" urges the Senate to consider modernizing the NFIP by increasing maximum coverage limits and by allowing FEMA to offer the purchase of optional business interruption and additional living expenses coverage.

The inclusion of optional business interruption coverage is particularly important to Big "I" members and their commercial customers. If a flooding catastrophe causes a business' premises to be temporarily unusable, that business may have to relocate or even close down temporarily. Property owners are still required to pay employees, mortgages, leases and other debts during this process, and these ongoing expenses can mount up quickly for a business on reduced income or no income at all. For property insurance policies, business interruption insurance provides protection against the loss of profits and continuing fixed expenses resulting from an interruption in commercial activities due to the occurrence of a peril. The inclusion of an optional business interruption provision at actuarial rates will provide stability to the local economies in the areas affected by flood damage and will offset Government disaster relief payments should the flood peril result in widespread destruction across a region. Business interruption coverage, and the security and peace of mind it provides, is important to our members and to small businesspeople across America.

The Big “I” also strongly supports the option for a consumer to purchase additional living expenses. Additional living expenses coverage would allow the consumer to purchase, at an actuarial price, a dollar amount of coverage for such expenses as hotel, food, replacement clothes, *etc.,* should the consumer be dislocated from his or her residence. This provision will provide consumers with greater security during the often bewildering post-flood period, and will do so in an actuarial basis as opposed to relying solely on FEMA grants and assistance.

Both the optional business interruption and additional living expense coverages are common in the private market for other perils, but are specifically excluded for flood insurance and are not currently available through the NFIP. Unfortunately, this gap in coverage leaves consumers unprotected and in many cases confused, as consumers falsely believe that they are either covered for such losses by their private insurance or their NFIP policies.

The business interruption and additional living expenses coverage were not present in the 2007 Senate FIRM Act, but we urge the Committee to reconsider their inclusion in the new reform legislation. In particular, we urge the Committee to consider modifications made to language in the House of Representatives that we feel rein in any potential for an impingement on the private market or a deleterious effect on taxpayers. New language added this year imposes three important factors that must be met before FEMA could consider offering the coverages: that FEMA charges actuarial rates for the coverage, that FEMA makes a determination that a competitive private market does not currently exist, and that FEMA certify that these coverages will not result in any additional borrowing from the Treasury. Additionally new language was added that limits the amount of optional business interruption coverage at $20,000 and additional living expenses at $5,000. The Big “I” supports the goals of each of these conditions and the limits and believes their addition should put at ease any concerns that stakeholders may have over their inclusion. In fact, the CBO recently released its score of the House bill and specifically noted that they do not anticipate the business interruption and additional living expenses provisions to have any impact on Federal revenues.

Finally, also chief among our additional recommendations is the proposed increase in the maximum coverage limits. The NFIP maximum coverage limits have not been increased since 1994. An increase in the maximum coverage limits by indexing them for inflation will better allow both individuals and commercial businesses to insure against the damages that massive flooding can cause and will increase the program’s popularity and take-up rates. The CBO score on the House reform legislation also found that indexing maximum coverage limits to inflation would have no effect on Federal revenues.

**Privatization of the NFIP**

Some observers have argued that the program should be eliminated or completely privatized. These arguments center on the assumption that the private market could step in and offer flood insurance coverage. However, the IIABA has met with many insurance carriers who categorically state that the private market is simply unable to underwrite this inherently difficult catastrophic risk, especially in the most high-risk zones where it is needed. IIABA would always prefer to utilize the private market, and our members would almost certainly prefer to work directly with private insurance carriers rather than a Government agency. However, where there is a failure in the marketplace, as there is in the case of flood insurance, we believe it is imperative that the Government step in to ensure that consumers have the protection they need. This was the reason the NFIP was first created in 1968, because the private market could not offer flood insurance and a series of high profile floods had consumers turning to direct Federal disaster assistance as their only recourse. We see no evidence that the private marketplace is any more prepared or capable of underwriting flood risk in 2011 than they were in 1968.

We do not, however, oppose any Government studies on private market capacity. We believe that these studies will likely show that the private market cannot properly underwrite flood risks, but if it can be demonstrated that a private market could emerge in some way, we would welcome that discussion.

**COASTAL Act**

The Big "I" appreciates Senator Roger Wicker's (R–MS) efforts to address the complicated issue of loss allocation of wind *versus* water damage on total loss properties following named storm events. Hurricane Katrina clearly demonstrated both the devastating power of hurricanes as well as the havoc they can wreak on homeowners that are left with nothing more than slabs of concrete where their home once stood. Independent insurance agents pride themselves on standing with their consumer throughout the entire claims process, and the difficult and often lengthy loss adjudication process between flood damage and wind damage following Hurricane Katrina was clearly an undue burden on many consumers. It is important that a clear method of allocating these losses in both a fair and timely manner is developed, and we look forward to continuing to work with Senator Wicker and this Committee on developing such a process.

**Conclusion**

The IIABA is very pleased that the Committee is conducting today's hearing on comprehensive flood insurance reform and we urge the Senate Banking Committee to quickly develop legislation and send it to the full Senate for action. As we have stated, we believe the Flood Insurance Reform and Modernization Act of 2007 is a useful starting point for developing new legislation, and urge the Committee to also consider adding provisions allowing the offering of optional business interruption and additional living expenses at actuarial rates. We hope very much that this hearing will contribute to additional action taken by Congress to pass flood insurance reforms and to ensure the stability of the NFIP.

---

## STATEMENT SUBMITTED BY CRAIG POULTON, CEO OF POULTON ASSOCIATES, INC.

My name is Craig Poulton. I am the CEO of Poulton Associates Inc. which is located in Salt Lake City Utah. Poulton Associates is engaged in the business of property and casualty insurance brokerage. Our organization acts as the administrator of the Natural Catastrophe Insurance Program. The Natural Catastrophe Insurance Program is available in all 50 States through over 2,500 independent insurance producers. Under the Natural Catastrophe Insurance Program the perils of flood, earthquake and landslide may be insured for both personal and commercial properties through Certain Underwriters at Lloyds (London). Thank you for allowing us to participate in this hearing.

With the exception of insurance policies backed by the Federal Government through the National Flood Insurance Program (NFIP), the Natural Catastrophe Insurance Program is the largest provider of primary flood insurance coverage in the United States with well over $2.2 billion in property values being insured for the risk of flood on a primary basis.

Perhaps the most illuminating thing I could point out for your consideration is that after 7 years of aggressively marketing the Natural Catastrophe Insurance Program we have been able to capture only about one-tenth of one percent of the flood insurance market represented by the 5.5 million risks insured through the NFIP.

One might initially suppose that we have been, by and large, unsuccessful in our efforts to penetrate the primary flood insurance market because the insurance coverage we offer is somehow less appealing or the pricing is much higher than that available through the NFIP. This is not the case; in fact our product is widely recognized by laypersons and insurance professionals (including the over 2,500 who market the product) as being superior in both coverage and pricing to the insurance coverage available through the NFIP.

Flood zone borrowers will often explore alternatives to the NFIP by looking for competitively priced privately backed non-NFIP policies. They often find that our policy is more attractive than the NFIP policy; since they have been informed that they have the option to choose private flood insurance, they do so and submit it to the lender to comply with the Mandatory Purchase Requirement. Often, just hours prior to loan closing, the borrower is informed by the lender that the coverage they have elected and paid for will not be accepted to satisfy the terms of the Mandatory Purchase Requirement.

Often the lenders' paradoxical rational is that the policy is a non-NFIP private policy and is therefore not acceptable, even though as required under the Act, it was the lender who informed the borrower that private coverage may be available. The lender will explain that their Federal regulator/auditor will not accept anything but NFIP coverage, even if the coverage provided by us is in the best interest of the property owner and the lender from a coverage and pricing standpoint.

The borrower is then forced to either cancel our policy and purchase an NFIP policy, or walk away from the purchase arrangement. As one would expect, the borrower rushes to cancel our policy and purchase NFIP coverage.

The reason we have been relatively unsuccessful in our efforts is that, even though Congress obviously intended for the NFIP to be a stepping stone to the assumption of primary flood risk by the private market, the NFIP and Federal Lending Regulators have combined to preclude our program from being accepted by the mortgage banking community as a satisfactory replacement for NFIP insurance.

This unfortunate circumstance results from the fact that regulators at the NFIP publish a booklet known as the "Mandatory Purchase of Flood Insurance Guidelines" typically referred to as the Mandatory Purchase Booklet. This booklet contains a series of six guidelines describing what a private insurance policy should look like in order to be acceptable in the place of an NFIP policy. In addition the booklet includes the following instruction, " . . . a lender should understand and comply with FEMA's criteria for selection of private insurer and the form of Coverage."

The problem is that having published these guidelines FEMA/NFIP officially refuses to interpret them. No one has been designated by FEMA or the NFIP to interpret these guidelines. Like any law the guidelines need someone to interpret them. In the United States Congress makes laws and the courts interpret those laws when necessary. In this case, FEMA/NFIP has acted to create what has been taken for the law but has provided no one to interpret it or adjudicate differences of interpretation.

Federal Lending Regulators have implemented the Mandatory Purchase Booklet guidelines in such a way that FEMA is now perceived as a *de facto* private flood insurance regulator among Federal Lending Regulators and regulated lenders. In FEMA's efforts to issue appropriate rules and regulations, FEMA has created an impression of authority which is absolute but leaves Federal Lending Regulators and regulated lenders in the dark as far as which private insurance policies are acceptable. As a default position, most lenders simply elect to preclude all private insurance policies from being accepted in the place of NFIP insurance policies.

I don't think it is too difficult to see why with an attractively priced product providing broader coverage, we have been unable to compete effectively against NFIP. Federal Lending Regulators, being without expertise in insurance regulation, take what they see as the most conservative position: that if a private insurance policy is not identical to the NFIP policy, it is not acceptable. This, of course, limits consumer choice, forces taxpayers to assume even more flood risk and limits competition.

Consider, in concert with all of this, that virtually all insurance regulation in the United States is accomplished by State insurance regulators and that the NFIP policy, which is not State regulated, has many provisions that would not be allowed in most States. Now, consider the fact that NFIP guidelines are implemented by Federal Lending Regulators in such a way that they require private, State regulated policies to be exactly like the NFIP policy. This puts us in a classic "Catch 22", with no way to compete without violating a perceived Federal regulation or a very real State regulation.

As part of the notification process, Congress requires the lender to provide written notification to the borrower which includes, " . . . a statement that flood insurance may be purchased under the national flood insurance program and is also available from private insurers." And yet, Federal regulation has made private flood insurance effectively unavailable.

You may find the following examples and observations about the unintended consequences which have been born of the current regulatory paradigm revealing.

Because the NFIP guidelines are so vague, bank regulators reject private policies because the private policy contains State mandated cancelation provisions beneficial to the insured but not "allowed" by the bank regulator's interpretation of the NFIP guidelines and NFIP cancellation provisions. For example, NFIP will not refund any premium if the insured cancels the policy; however, private carriers must return the premium in order to comply with State law.

Additionally, NFIP forces each detached structure to be insured on a separate policy. State regulators disallow the practice of selling multiple insurance policies on the same property when it could be done more inexpensively under a single contract. Bank regulators consistently require that the home and the garage and the shed and the chicken coop and the rabbit hutch be insured, each under its own insurance policy because "that is the way NFIP does it." This occurs even though private insurance policies such as ours typically provide automatic coverage on the garage, shed, chicken coop and rabbit hutch at no additional charge under a combined limit.

The FEMA private insurance guidelines have some obviously foolish requirements such as that found in Section 5. Private Flood Insurance, f. Legal Recourse, which says: "The policy must contain a provision that the insured must file suit within 1-year after the date of written denial of all or part of the claim." The result of this provision is to force a private insurer to limit the recourse of the buyer because "that is the way NFIP does it." This results in requiring the private insurance company to adopt a provision which is directly against the public interest, as well as being against the interest of each policyholder.

In direct contradiction of the congressionally mandated requirement that notification of the availability of private insurance is to be given to all borrowers, agencies such as Fannie Mae and the FHA specifically require that the borrower obtain a National Flood Insurance Policy to satisfy the Mandatory Purchase Requirement. The Fannie Mae regulations state that flood policies should generally be issued directly by the NFIP, or alternatively, a policy may be obtained by licensed property and casualty insurance company authorized as a "Write Your Own" (WYO) participant. The Federal Housing Administration Handbook states, "Insurance under the NFIP must be obtained as a condition of closing and maintained for the life of the loan for an existing property when any portion of the residential improvements is determined to be located in a SFHA." Thus, Fannie Mae and the FHA have summarily limited choice to NFIP flood coverage only for millions of borrowers.

NFIP's Lender Compliance Officers and Federal Lending Regulators consistently recognize the validity of privately backed insurance policies known as "force placed" primary flood coverage on properties where the borrower has not furnished flood insurance to satisfy the Mandatory Purchase Requirement. FEMA estimates that these non-NFIP policies placed by the lender equaled approximately 100,000 to 200,000 risks in 2004. These policies obtained by the lender are typically placed with Lloyd's of London under a more restrictive form to the one we offer. Yet regulators take no issue with lenders purchasing flood insurance on this more restrictive Lloyds of London coverage form, while they deny individual borrowers the same freedom of choice. Shouldn't consumers have the same option as is allowed to the bank in choosing the best coverage they can find?

Stretching believability by comparison, our most widely purchased policy which provides coverage for flood, earthquake, and landslide has often been rejected by Federal Lending Regulators because we cover MORE PERILS than the NFIP policy. The NFIP will only cover flood while our policies routinely cover multiple perils. This circumstance is stunning and this interpretation of the guidelines is clearly not in the interest of the consumer, but it continues to happen because, "that's not how NFIP does it."

Our program has many other enhancements not available under NFIP such as much higher limits of coverage, a broader policy definition of flood, coverage for additional living expense for homeowners and business income and extra expenses for property owners, coverage for increased cost of building materials and coverage for finished basements and basement contents, to name a few. In addition, we offer coverage for the perils of earthquake, flood and landslide at a competitive price when compared to flood only coverage from NFIP. When our flood insurance is purchased, it is most often provided in combination with coverage for earthquake and/or landslide, thus insulating the Federal balance sheet from loss due to the need to provide disaster recovery assistance for losses from the perils of earthquake and landslide. When you think of this in relation to the fact that Federal Lending Regulators cite to much coverage as a reason to reject our policy, it is just staggering. We have submitted as part of this testimony a brief comparison of the NFIP policy and the policy form most purchased by consumers under our program.

By establishing the National Flood Insurance Act, Congress clearly intended that regulators should encourage, not discourage, the acceptance of private flood insurance by financial institutions in addition to, or in lieu of, NFIP coverage.

Regulatory practices should foster and support free market participation and creativity, rather than limiting the consumer to NFIP products. Insurance products and services should be allowed to enter the market unfettered by over-reaching regulatory mandates and guidelines, thus benefiting consumers by giving them options that meet their needs while spreading the risk of flood loss.

It seems to us that the current situation can be most easily and simply corrected by directing FEMA and all Federal Lending Regulators to recognize that, like all other private property insurance policies, private flood insurance is regulated by the States. State regulators should be charged with the interpretation and enforcement of the existing Private Insurance Guidelines published by FEMA along with any applicable State regulations. In this way, Congress will provide for interpretation of all regulations by qualified regulators who can bring consistency and harmony to the process of regulating private flood insurance. This course of action will improve outcomes for all concerned while actually reducing the cost of administration for all parties, especially the Federal Government. It will be crucial to disallow FEMA from creating any additional guidelines in order that unmanageable complications do not destroy the ability of State regulators to modify, coordinate, and synchronize Federal and State regulations in the long term.

In many developed countries, flood risk is entirely shouldered by the private market. Because the NFIP has been allowed to become "the only game in town" for so many years, the vast majority of people are not even aware that private primary flood insurance is available in the United States. If decisive actions to support the private market are not taken by Congress soon, over time, there will be no private alternative to taxpayer funded flood insurance in the United States. By taking action now, Congress can spread the assumption of flood risk more widely, provide consumers with real options, and give taxpayers greater protection from unnecessary exposure to federally funded flood insurance losses.

Thank you.

| Natural Catastrophe Insurance Program | | National Flood Insurance Program | |
|---|---|---|---|
| **Features** | **NCIP** | **NFIP** | **Comments** |
| Limit to $5,000,000? | Yes | **No** | NFIP $250,000 Residential $500,000 Commercial |
| $5,000,000 Stop Loss Limit Option? | Yes | **No** | NCIP allows risks between $5 Mil and $15 Mil in values to receive a $5 Mil limit with no Coinsurance Penalty. |
| Covers Earthquake? | Yes | **No** | |
| Covers Flood? | Yes | Yes | |
| Covers Landslide? | Yes | **No** | |
| Coverage becomes effective 15 days after policy inception for the peril of flood? | Yes | **No** | **NFIP requires a 30 day wait after policy inception before flood coverage is in force.** |
| Require Annual Application? | No | No | |
| Broad Deffinition of Flood? | Yes | **No** | NFIP requires 2 homes or two acres to be inundated to trigger coverage. NCIP has no such limitations. |
| Deductible for Earthquake? | Yes | **No Coverage** | NCIP Personal 5% or Choose the "Greater of" $2,500 or 5%. NCIP Commercial choose 10% or 5%. |
| Deductible for Flood? | Yes | Yes | NCIP Personal choose $1,000 or 5% NCIP Commercial the "Greater of" $2,000 or 2%. |
| Deductible for Landslide? | Yes | **No Coverage** | NCIP Personal choose $1,000 or 5% NCIP Commercial the "Greater of" $2,000 or 2%. |
| $1000 Flood Dedcut in Zone A? | Yes | Yes | Optional |
| Replacement Cost on Dwelling? | Yes | Yes | |
| Replacement Cost on Contents? | Yes | No | "New for Old" |
| Specified Amount for Contents? | Yes | No | NCIP Allows Increased Contents Limit |
| Specified Amount for Appurtenant? | Yes | No | NCIP Allows Increased Appurtenant Structures Limit. |
| Age Limit on Dwellings? | No | No | |
| Require Annual Application? | No | No | |
| Pay on Commission Basis? | Yes | Yes | |
| Renewal Commission? | Yes | Yes | |
| Direct Bill on Renewal? | Yes | No | Automatic on Renewal - NCIP |
| Increased Cost of Materials? | Yes | No | Due to Catastrophe Shortages |
| Cover Rental Property? | Yes | No | If Primary also Covered by NCIP |
| Cover Commercial Property? | Yes | Yes | Through NCIP Commercial |
| Cover Additional Living Expense? | Yes | **No** | |
| RCV on Secondary Dwellings? | Yes | No | |
| Separate Debris Removal Limit? | Yes | No | |
| Contents in Basement Covered? | Yes | **No** | |
| Course of Construction? | Yes | **No** | |
| Decks Covered? | Yes | 16 Sq. Feet | |
| Carports Covered? | Yes | **No** | |
| Policy Issued in Producers Office? | Yes | **No** | |

Rev. 6-17-2011

## STATEMENT SUBMITTED BY THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

### Introduction

The Property Casualty Insurers Association of America (PCI) believes that the National Flood Insurance Program (NFIP) is a necessary public policy program that should be continued. Currently, the flood program is set to expire at the end of September this year.

We commend Chairman Johnson, Ranking Member Shelby, and the Members of this Committee for taking up this issue in a timely manner. We would urge you to pass legislation providing for a long-term reauthorization of the NFIP as soon as possible. There have been ten short-term extensions of the program since September 30, 2008, and there were four "lapses" in the program in 2010, causing significant disruption in the vulnerable housing markets at a time when the U.S. economy and particularly the housing sector is struggling to recover from the recent financial crisis.

While significant reforms in the NFIP are needed, we believe that such changes should be kept to a minimum. There are more than 5.6 million NFIP policyholders in the U.S., and a long-term reauthorization of the program is essential to help provide stable protection for the country's property owners.

PCI believes the most important reforms are as follows, and several were addressed in the legislation that passed in the Senate in 2008 (S. 2284):

*The Program Should Be Reauthorized on a Long-Term Basis (e.g., for 5 Years)*

The program has been extended on a short-term basis a total of 10 times since its original expiration on September 30, 2008, and is set to expire again on September 30, 2011. A long-term reauthorization will ensure that there will be no gaps in coverage, which occurred four times in 2010 alone, each one longer than the previous.

Gaps in coverage caused significant disruption in the housing markets. Home buyers in flood zones with a federally backed mortgage are required to purchase flood coverage before the property can be closed on, and last year, over 40,000 real estate transactions were delayed because of the NFIP expirations.

The following are specific changes in the program that should be addressed as Congress considers improvements in the program:

*Fix the Rate Structure*

The rates charged for certain properties in the NFIP have been subsidized since its inception in 1968. It is time that these subsidies end and that the true cost of insuring property in hazardous areas is reflected in the premiums for those properties. These properties should not continue to be subsidized by other NFIP policyholders or U.S. taxpayers.

Long term reauthorization passed by the Senate in the 110th Congress included raising the maximum annual rate increase from 10 to 15 percent (and up to 25 percent until the appropriate premiums are being charged). This is critical as we believe that the premiums should reflect the risk of loss. The previous bill also increased the minimum deductibles which we believe more appropriately represents deductible amounts in the private market for homes and businesses. Increasing the deductible amount should also help from a fiscal standpoint as smaller losses would be absorbed by the policyholder and the vital protection provided for significant losses would be protected.

PCI also believes that a reserve fund, setting aside 1 percent of total potential loss exposure as proposed in the 2008 legislation, is important. Increasing the rates is the first step; however, the program must begin to further offset the significant subsidy (which FEMA states is 40–45 percent for pre-FIRM properties). The rates need to be closer to the true market rate before any discussion related to the private industry taking on flood risk can take place.

PCI estimates that flood insurance premiums would potentially need to double, and in some cases triple if the private insurance market was to write this business on a primary basis (see attached). Proposals to end the NFIP's primary flood underwriting are unrealistic given the current steep subsidies and the recognized unwillingness of many homeowners to purchase coverage even when mandated and at highly subsidized rates.

*Depopulate the NFIP Direct Program*

In 2010, the second-largest WYO program participant decided that the cost of participation and the litigation exposure were too great given the current reimbursement amount. PCI is opposed to any reduction or other proposal that would further impact the number of WYOs participating in the program.

The departure of the second largest WYO participant created another problem, a 700 percent growth in the amount of business being written in the NFIP "direct" program. When a WYO insurer decides or is forced to leave the program, there are two options for these policies through an agreement with the departing insurer and the NFIP: (1) contracting with one or more other WYO insurers to assume the business at renewal; or (2) placing it in the "direct" program administered by the NFIP. The "direct" program had roughly 125,000 policies at the beginning of October, 2010. With the departure of this large WYO insurer and a decision by that insurer to put the business in the "direct" program, the program will now have more than 900,000 policyholders, making it the largest servicing entity in the program. This could create significant problems regarding staff handling claims following a major flooding event.

PCI believes that this "direct" business should be redistributed and administered by private insurers who are part of the WYO program. As previously mentioned, the WYO program has been a significant success with regard to increasing the awareness and purchase of flood insurance nationwide. The number of policyholders in the program has more than tripled and taxpayers, policyholders, and the Federal Government benefit from the private insurance industry infrastructure. PCI would encourage you to look at a legislative approach to reduce the size of the NFIP "direct" program such as setting a cap and pushing policies eligible to be written by WYO participating insurers back into the private sector. We pledge to work with you and interested stakeholders on this important issue.

*Address Servicing Issues*

The "Write-Your-Own" (WYO) program, established in 1984, has been very successful increasing participation in the NFIP; however, it has also been the subject of legislative discussion over the past few years. There have been issues related to loss settlement, expense reimbursement and participation in the NFIP by WYO insurers.

Following Hurricane Katrina, there were significant issues related to the settlement of wind and water losses. However, many of these issues would have been addressed by the application of the NFIP appeals process that was included in the Flood Insurance Reform Act of 2004. Unfortunately, that process was not ready when Katrina hit.

S. 2284 called for a National Flood Insurance Advocate as one way to address policyholder issues. PCI is opposed to the creation of yet another Federal Government office that would, essentially, be charged with appeals and other responsibilities addressed by the flood insurance legislation enacted in 2004. This would be duplicative of existing methods available to NFIP policyholders. That legislation also required that insurers file information with the NFIP related to any claims related to wind losses. This is inappropriate. Many insurers are not involved with the NFIP program at all. This provision would further the Federal regulation of entities already very heavily regulated at the State level. In fact, any concerns expressed by a policyholder with regard to the handling of the claim fall under and can be addressed through other methods and by State claims settlement practices acts.

A new legislative proposal calls for allocation of wind and water damages by a Federal agency after the event as a way to solve this problem. PCI does not believe that this approach is viable or appropriate. It calls for the use of this process only with regard to "indeterminate losses" (*i.e.,* where the cause cannot be determined) for total losses (*e.g.,* "slab" claims). We believe that despite the restrictive language, it will be used for other flood or wind loss related claims as well. While well-intentioned, this proposal has the effect of federally regulating private insurance entities that, more likely than not, are not even involved with the Federal NFIP.

The allocation sets up the expectation for policyholders that, once the percentages are determined, the total of the payments will equal 100 percent of the loss. In fact, due to the many coverage differences between the property insurance policy and the NFIP policy (*e.g.*, the aforementioned additional living expenses included in a homeowners policy), this will not be the case. It may also create more litigation since there are specific State laws that require claims to be settled within a specific time frame. Those time frames are typically significantly shorter than the proposed 90 days to establish the allocation formula. The formula would also allocate based a general geographical area, not a specific property location. Finally, we know following Hurricane Ike (2008), some allocation formulas were used following this event. This method was later challenged through litigation that has just been settled for $200 million. We would be happy to discuss other issues related to this approach with Members of the Committee.

The expense reimbursement has also been the subject of debate without any changes that would help reduce costs. Following Katrina, the NFIP worked with the

WYO participating insurers to revise the claims expense reimbursement when significant catastrophes occur. The NFIP reduced the amount of the claims expense reimbursement where the number of losses are significant and insurers and the NFIP benefit from some economies of scale. Another issue is that the number of actively writing WYO participants continues to drop.

*Fix the Maps*

We understand that numerous issues have surfaced regarding the certification of levees and the ongoing map modernization efforts. We believe that a phase-in for these purchasers as well as the reestablishment of the Technical Mapping Advisory Council are important steps in addressing these significant issues for consumers, communities, the States and policyholders. We would ask that our industry be represented by inclusion of a representative of a flood insurance servicing carrier (a "Write-Your-Own" company) on this Council.

PCI would encourage the extension of the Flood Insurance Reform Act of 2004 program for Severe Repetitive Loss Properties. It is time to buy-out, or otherwise charge the appropriate premium for these properties that continually flood and are rebuilt time after time.

PCI also supports the inclusion of nationally recognized building codes in the floodplain management criteria. This would require FEMA/NFIP to work with the building code councils to include this information. It would provide for better construction of properties and help minimize damage from a variety of perils, including flood as well as reduce the repetitive loss properties over time.

*Include Additional Living Expenses and Business Interruption*

We believe that including some minimum protection, with the appropriate risk-based premium charge, for additional living expense coverage for residential properties as well as optional business interruption coverage is important and should be part of any reform. Additional living expenses help consumers and business interruption coverage helps business owners immediately move forward after a flood. This is a significant difference between the coverage that has been traditionally provided by private market property policies and the lack of such coverage in the flood policy. This has also been the subject of policyholder problems and litigation where there are losses under a flood policy as well as under a private or State policy providing windstorm protection.

**Conclusion**

PCI is very pleased that the Committee is taking up this important issue at this time in an effort to provide for a long-term reauthorization of the program before another lapse occurs. We are eager to work with the Committee on legislation that would put the NFIP on a more sound financial footing by eliminating rate subsidies and addressing mapping issues. Finally, we believe that minimizing Federal intervention in private entities and providing private WYO insurers with the tools to service NFIP policyholders and the Government with access to and the economies of scale of our members' infrastructure is extremely important.

Therefore, we would support passage of reauthorization and reform legislation and pledge to work with you to improve the National Flood Insurance Program. Thank you.