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**Legislative Proposals to Reform the
National Flood Insurance Program**

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**Subcommittee on Insurance, Housing and
Community Opportunity**

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I. Introduction

Good morning Chairwoman Biggert, Ranking Member Gutierrez, and distinguished Members of the Subcommittee. 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 National Flood Insurance Program 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. The NFIP must continue to offer affordable insurance that will properly identify those 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 also plan to discuss the recent efforts of FEMA's NFIP Reform Working Group, which develops policy recommendations for comprehensive NFIP reform for the Secretary 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 partner in all of our NFIP efforts, and we appreciate your attention to this important matter.

II. 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 risk in the United States.

History of the NFIP

Major flood disasters in the United States in the 1920s and 1930s led to federal involvement in the effort to protect lives and property from flooding. Even though Congress enacted the 1936 Flood Control Act to reduce the overall risk of flooding, 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 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 corrective and 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. The Flood Mitigation Assistance program (FMA) also dealt with the effort to reduce loss of life and property by lessening the impact of disasters. FMA was created as part of the National Flood Insurance Reform Act of 1994 to reduce NFIP claims. This law established a FMA Grant Program to assist states and communities to develop mitigation plans and implement measures to reduce future flood damages.

The NFIP, with the inherent 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 in each participating community 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 ten 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 eight 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 FY 2009, 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 flood insurance policies 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. Two of the most notable of these reforms are the creation of Preferred Risk Policies and Scientific Resolution Panels.

Scientific Resolution Panels

Flood hazards are constantly changing. For that reason, FEMA regularly updates Flood Insurance Rate Maps (FIRMs) to reflect those changes. When changes to the FIRMs are met with conflicting technical and scientific data, an independent third-party review of the information may be used to ensure the FIRMs are updated correctly.

FEMA's new Scientific Resolution Panel (SRP) process, established in November 2010, serves as an independent third party in order 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 relate to the creation of Flood Hazard Maps and Flood Insurance Studies throughout the United States. Based on the scientific and technical data submitted by the 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, with the support of Congress, FEMA began to implement several initiatives to update our flood maps, especially in those areas that are subject to a high risk of flooding. These initiatives include the Flood Map Modernization program (called MapMod), risk mapping, assessment and planning (by way of Risk MAP), and the Provisionally Accredited Levee (PAL) program.

These flood map updating efforts have yielded maps that more accurately calculate the flood risk. As a result of these efforts, many buildings that were previously considered low-risk have

been designated as Special Flood Hazard Areas (SFHAs). The flood risk is real and many property owners now find themselves in high-risk areas, and subject to a flood insurance purchase requirement. Notably, approximately the same number of structures have been removed from the SFHAs as have been added as a result of FEMA's updated mapping program.

While these map changes provide a more accurate reflection of a community's flood risk and will minimize the long-term risks and costs to people and property from the effects of flooding, FEMA recognizes the financial hardship that SFHA designation may place on individuals in newly identified SFHAs. Consequently, last year, FEMA announced a policy that went into effect on January 1, 2011, extending eligibility of low-cost preferred risk policies (PRPs) for individuals newly mapped into an SFHA.

Pursuant to the new PRP eligibility extension, owners of buildings newly mapped into an SFHA on or after October 1, 2008, and before January 1, 2011, are eligible to receive a reduced premium for up to two policy years beginning January 1, 2011 through December 31, 2012. Owners of buildings that will be added to an SFHA because of a map revision on or after January 1, 2011, are eligible to receive up to two policy years of reduced premiums after a map revision.

Eligibility extension of PRPs 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 two-year extension provides more time for the affected communities to upgrade or mitigate flood control structures to meet FEMA standards and reduce the flood risk. This reduces the financial impact on residents and businesses in the long term while making their communities safer and stronger.

The NFIP has successfully reduced flood risk 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 policy holders, a modernized flood hazard data inventory, and a suite of incentives driving risk reduction across the nation. Clearly, the program has improved the resistance of existing and new construction to flooding 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.

III. NFIP Reform Working Group

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 Subcommittee 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 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 non-profit 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 is comprised of 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 website.

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 and professional associations; and review and analysis of scholarly works. We have been reaching out and coordinating our reform efforts with other federal agencies. One example is through The Federal Interagency Floodplain Management Task Force which is comprised of twelve federal agencies and whose purpose is to promote the health, safety, and welfare of the public by encouraging programs and policies that reduce flood losses and protect the natural 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, economic development and environmental protection. I would like to briefly discuss 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 at reasonable terms and conditions to those who have need.”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, is a topic 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 the new and more accurate map expands the 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.

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,

¹ Title 42 USC Chapter 50 4001(a)

may become liabilities during a severe flooding event. As written by the Association of State Floodplain Managers: “[I]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.

The extent to which the NFIP encourages or accelerates floodplain development, and the adverse environmental consequences that often result from that development, remains a significant source of concern. Recently, a number of Endangered Species Act (ESA) lawsuits have been filed across the country based on the Agency’s implementation of the NFIP. Several environmental groups have alleged that FEMA incentivizes and encourages development in floodplains that jeopardizes the continued survival of endangered species and results in the adverse modification of critical habitat. These lawsuits allege that FEMA has failed to adequately assess and address the potential effects of the NFIP on endangered species and habitat, and that FEMA has failed to use its authority to carry out programs to preserve certain species, as required by the ESA. ESA litigation against the agency based on implementation of the NFIP is currently ongoing in several states. As a result, concerns about the impact of the NFIP on the environment are a prominent element of the public debate about the program.

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 incur repeated loss and damages that significantly drain the NFIP, subsidies, insurance ratings, building standards, and incentives and disincentives for mitigation.

IV. 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 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 Policy Option

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

² Association of State Floodplain Managers Whitepaper, Critical Facilities and Flood Risk; November 10, 2010.

Your Own” insurance companies that participate in the program or by FEMA directly. Thus, while the community issues permits for construction in the floodplain, the policyholder bears the cost of insuring against flood risk through the payment of an annual flood insurance premium. 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 Policy Option

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, a number of our stakeholders have indicated that 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 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 un-insurable 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.

Federal Assistance Policy Option

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 from NFIP.

Optimization of Current Program Policy Option

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, properties that are a significant drain on the NFIP (e.g. 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 multi-year 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.

V. Conclusion

FEMA uses the NFIP to help communities increase their resilience to disaster through risk analysis, risk reduction, and risk insurance. The NFIP 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 on-going 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.