LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM, PART I

HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING, AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM, PART I

Friday, March 11, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INSURANCE, HOUSING,
AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Capito, Westmoreland, Duffy, Dold; Gutierrez, Waters, Cleaver, and Sherman.

Also present: Representatives Palazzo and McCarthy of New York.

Chairwoman BIGGERT. This hearing of the Subcommittee on Insurance, Housing, and Community Opportunity will come to order.

Let me just say before we start that I would like to take a minute to express the deepest sympathy for the people of Japan as they cope with the aftermath of this terrible earthquake and tsunami. While reports of the damage continue to surface, it is clear this disastrous event will leave an indelible mark on the region. My thoughts and prayers—and I am sure all of us who are here agree—are with the people of Japan, not to mention our hopes that the effects on Hawaii and the West Coast will be minimal.

And I would like to note that Administrator Fugate cannot join us today, given that he must remain at the FEMA headquarters to monitor the developments in Hawaii, Alaska, the West Coast, and the Pacific Territories and to coordinate possible Federal assistance to State and local governments. So, we understand his responsibilities, and we hope that we will meet with the Administrator within the next few weeks.

With that, we are going to have opening statements. I will start, and welcome the witnesses to today's hearing where we will examine legislative proposals to reform the National Flood Insurance Program, or NFIP.

It is critical that, well in advance of NFIP's September 30th expiration date, Congress begin a dialogue and shape a reform measure. Millions of homeowners and businesses in Illinois and across the country, not to mention our recovering housing market, can ill afford the turmoil caused by a program lapse, which occurred during the previous Congress.

That said, to the credit of my colleague, Ms. Waters, the former subcommittee chair, much progress was made on NFIP reform legislation, some of which is included in the draft bill that is under discussion today.

There is no question that the program is in dire need of reform. For many years, the NFIP has been—for lack of a better phrase—underwater, with longstanding management and financial challenges, and was last reformed in 2004. The NFIP borrowed millions from taxpayers following the 2005 Gulf Coast hurricanes and continues to be financially unstable.

Since 2006, the NFIP has been cited by the Government Accountability Office as a high-risk Federal program in need of fundamental reform.

It is crucial that we work to restore the financial integrity of the NFIP so that homeowners and businesses in floodplain areas, like many in my State of Illinois, are not left without any protection, and taxpayers are not on the hook for the failure of the NFIP.

We must work towards a long-term plan for flood insurance that eliminates taxpayer risk in the near-term. Important reforms to the NFIP must improve its financial stability, reduce the burden on taxpayers, and examine ways to increase private market participation.

Today, I would like to welcome guest members to our committee, regulators, engineers, insurers and reinsurers, REALTORS®, home builders, and many other experts to examine near- and long-term strategies for a flood insurance program that our families, businesses, and local communities can count on.

With that, I recognize Ranking Member Gutierrez for his opening statement. We have agreed to limit the opening statements to 5 minutes.

Mr. GUTIERREZ. Good morning, Chairwoman Biggert, and everyone here today. I want to thank our witnesses for taking the time to testify. We are here to discuss legislative proposals to reform the National Flood Insurance Program.

As you may recall, we were successful in passing the Flood Insurance Reform Priorities Act of 2010 last summer, which was introduced by Congresswoman Waters. The bill received broad bipartisan support. But unfortunately, the Senate did not take it up, so here we are once again.

Since the program is slated to expire at the end of September, I hope we can once again work together to pass this critical, necessary legislation and not allow the program to lapse, as it has done in the past.

Finally, as we move forward, we need to make sure reauthorization adds stability to the National Flood Insurance Program and to our housing market.

I look forward to all the testimonies. I would like to introduce two statements for the record.

The first is from the American Insurance Association, Write Your Own Flood Insurance Coalition. AIA expresses the need for a meaningful and long-term extension and contributes to this ongoing discussion with their recommendations.

The second is from the National Wildlife Federation, a SmarterSafer Coalition, as it raises environmental concerns to keep in mind as we move forward with NFIP reform this year.

Thank you, Madam Chairwoman. I would like to see who else on our side would like some time, as time permits.

Chairwoman BIGGERT. Thank you.

At this point, I would ask unanimous consent that our colleague, Mr. Palazzo, can join our subcommittee and participate in the hearing today.

Without objection, it is so ordered.

Welcome.

And now, we recognize Representative Dold for 2 minutes.

Mr. DOLD. Thank you, Madam Chairwoman.

And I want to welcome you all here, as well, and thank you for being here.

The Flood Insurance Program insures more than 5 million residential and commercial property owners in more than 20,000 American communities. These millions of property owners and their communities depend on this program to provide some measure of security against inevitable flood risks.

At the same time, with this program's existing debt and with the persistence of federally-subsidized premiums, the program remains undercapitalized, and the program's financial solvency is in jeopardy—all of which places the American taxpayer at an ongoing, substantial risk.

Clearly, we need to minimize taxpayer risk by making this program more self-sufficient and by expanding the private sector's role in protecting against flood disasters. The important question for us is how to accomplish these important objectives.

One thing that also seems clear is that the strategy of short-term authorizations and the corresponding temporary program lapses have not worked to minimize taxpayer risk or to expand the private sector's role. In fact, the short-term authorizations and temporary lapses have had the opposite effect, while also destabilizing an already fragile housing market.

To properly reform and strengthen this program, we need to reauthorize this program on a long-term basis, and we need to do so promptly to avoid any additional lapses in the program. Long-term reauthorization will allow us to create stability and predictability for property owners, while moving towards meaningful and necessary reforms.

We must also gradually reduce Federal subsidies that keep flood insurance premiums artificially low, that keep private insurers out of the market, and that keep taxpayers on the hook for most of the flood losses. We must also consider how to deal with repetitive loss properties to index coverage for limits for inflation and to expand available coverages.

We need to consider policies that will limit adverse selection and better spread risks. We need to consider giving private market insurers some certainty and uniformity regarding applicable law when selling and administering policies under what is necessarily a national flood insurance market.

In the end, we need to create the conditions under which the taxpayer risk is minimized, private sector involvement is expanded, and policy owners are protected.

I look forward to working with the chairwoman and my colleagues on both sides of the aisle to achieve these most important national objectives.

I yield back.

Chairwoman BIGGERT. Thank you.

I would also like to ask for unanimous consent for Mrs. McCarthy, a member of the full committee, to participate in today's hearing.

Without objection, it is so ordered.

I will now recognize Mr. Cleaver for 2 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman, and Ranking Member Gutierrez.

The tsunami hitting Japan yesterday, or last night, provides us with a reminder of the devastation that can be caused by flooding. And it also is appropriately getting the attention of the FEMA Administrator, which is why the Administrator is not with us this morning.

Madam Chairwoman, I think that it is time that we do an overhaul of the NFIP, because, obviously, there are concerns. We attempted in the aftermath of Hurricane Katrina to provide some reform to the program, but we did not get very far.

Something has to be done. We are about $18 billion underwater—pardon the pun—and the program simply cannot continue as it is now.

We need to struggle with—and debate, if necessary—the issue of the wind damage coverage, which was one of the controversies when we tried to deal with this issue back in 2009.

So, I am looking forward to raising those questions about reform to our panel this morning, and to actually find out from them whether or not they believe that we have time to do anything before the September expiration date, because I think, expeditiously, maybe we can address this issue.

Thank you, Madam Chairwoman. I yield back.

Chairwoman BIGGERT. Thank you.

I would also like to submit for the record, by unanimous consent, written statements from Allstate, the National Association of Professional Insurance Agents, the International Code Council, Lloyds of London, and the National Multi Housing Council.

We will now start with our witnesses.

And I would also like to submit, without objection, the testimony of Administrator Fugate for the record.

Without objection, it is so ordered.

And we are happy to have with us: Orice Williams Brown, Managing Director of Financial Markets and Community Investment for the Government Accountability Office; and Sally McConkey, vice chair of the Association of State Floodplain Managers, and manager, Coordinated Hazard Assessment and Mapping Program, Illinois State Water Survey.

As you may know, you can address the dais for 5 minutes, and then we will follow that with questions and answers.

So, Ms. Brown, if you would like to be recognized for 5 minutes?

STATEMENT OF ORICE WILLIAMS BROWN, MANAGING DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Ms. BROWN. Thank you.

Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, I appreciate the opportunity to participate in today's hearing on the National Flood Insurance Program. As you know, floods are the most frequent national disaster in the United States, causing billions of dollars of damage each year.

This morning, I would like to share my thoughts on three areas: FEMA's administration of NFIP; the proposed reforms put forth in the discussion draft; and other possible areas for reform.

First, NFIP serves a vital role in providing protection against flooding to over 5.6 million policyholders nationwide. As you know, NFIP is one of 30 programs or areas on GAO's 2011 high-risk list.

It 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.

In our ongoing work examining FEMA's management of NFIP, our preliminary results reveal challenges in strategic planning, human capital planning, interagency collaboration, records management, acquisition management, and information technology. While FEMA continues to make some progress in addressing certain areas, fully addressing these fundamental issues will be vital to its long-term operational efficiency and stability.

Second, using the broad public policy goals identified by GAO on the role of the Federal Government in providing natural catastrophe insurance, I will share some thoughts on reforming NFIP as outlined in the discussion draft. These broad goals include charging rates that reflect the risk of flooding, limiting costs to the taxpayer, encouraging broad property owner participation, and encouraging private sector involvement.

Successfully reforming NFIP will require trade-offs among these often competing goals. For example, currently, nearly one in four policyholders does not pay a full risk rate, and others pay grandfathered rates.

The discussion draft addresses this structural issue by phasing out these rates over time. This not only results in rates that reflect the risk of flooding, but also can help minimize the cost to taxpayers, and could help encourage private sector participation.

The trade-off involves potentially losing 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, 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 goals of expanding participation in low-risk zones and areas subject to repeated flooding, but have low penetration rates, among others.

Encouraging private markets is the most difficult challenge, because there is currently no broad-base 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 a share of the risk. The concepts in the discussion draft would begin to address this issue by giving FEMA greater authority to explore alternatives. For example, the discussion draft addresses the possibility of reinsurance.

Finally, while the discussion draft begins to address many of the broad public policy goals, I would like to offer a few other areas for consideration as the reform discussion continues. For example, leveraging mitigation programs in ways to make them more effective including: clarifying FEMA's authority to charge higher rates when property owners refuse or do not respond to mitigation offers, or allowing FEMA to apply a surcharge when mitigation offers are refused; actuarial rates and whether they should be sufficient to pay for catastrophic losses and any borrowing from Treasury; appropriating for any subsidies until the full-risk rates are fully phased in; and authorizing FEMA to map for all present flood risks, including erosion.

Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, this concludes my oral comments, and I would be happy to answer any questions at the appropriate time. Thank you.

[The prepared statement of Ms. Brown can be found on page 48 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

I will now recognize Ms. McConkey for 5 minutes.

STATEMENT OF SALLY MCCONKEY, VICE CHAIR, ASSOCIATION OF STATE FLOODPLAIN MANAGERS, AND MANAGER, COORDINATED HAZARD ASSESSMENT AND MAPPING PROGRAM, ILLINOIS STATE WATER SURVEY

Ms. MCCONKEY. The Association of State Floodplain Managers (ASFPM) thanks this subcommittee, Chairwoman Biggert, and Ranking Member Gutierrez for your attention to the need to reauthorize the National Flood Insurance Program.

We very much appreciate your holding this hearing, and appreciate the opportunity to comment on the discussion draft legislation and to share our thoughts on the current status of the NFIP, challenges the program confronts, and opportunities to improve our Nation's efforts to reduce flood-related losses.

The Association of State Floodplain Managers and its 29 chapters represent over 14,000 State and local officials and other professionals who are engaged in floodplain management and hazard mitigation. All ASFPM members are concerned with working to reduce our Nation's flood-related losses.

ASFPM believes that the NFIP has been a useful Federal program for addressing flood losses in the Nation and it should be reauthorized without lapse. A reauthorization of 2 to 3 years is important for the stability of the NFIP, and the associated predictability is important for the lenders, the housing industry, home buyers, policyholders, and the Write Your Own insurance companies.

While a longer period of authorization is important, it must be balanced with the need to fully consider many important reform ideas which will need further evaluation and consideration by the committee.

There are fundamental issues that need to be thoroughly considered. For example, should the NFIP accommodate catastrophic losses rather than the average historical loss year? If so, are there realistic, affordable program adaptations that can achieve this objective? And if not, would it not be best to clarify that the program is not expected to cover catastrophic losses?

The Nation must carefully balance the issue of who benefits and who pays for develop at risk. We believe that a 2- to 3-year reauthorization would provide the needed reliability, while allowing time for FEMA to complete its "rethink the NFIP" project, and for Congress and the committee to thoroughly review and consider the significant policy and legislative options and recommendations for management and operation of the NFIP.

The report is expected out in June of 2011, and we think this project will identify, or does identify, the tensions and the tradeoffs of various options, and needs careful and deliberate consideration.

ASFPM identifies, and has identified, a number of concepts which we feel should be part of any reform. First, a comprehensive national flood risk management framework is needed to actually reduce flood-related losses of life and property in the Nation. We must move beyond the current NFIP minimum approaches and achieve a fuller integration of Federal programs.

Second, bold reforms should be considered to address current flood insurance issues. Flood insurance should gradually move towards being actuarially sound, to reflect actual risk and enable market-based financial decisions.

Third, floodplain mapping has changed significantly over the life of the program. Better technology, improved methods, and the creation of risk assessment techniques allow for the identification of flood hazard areas and enable the creation and distribution of this information to decision-makers.

Technological advances will continue, and a long-term authorization of the mapping program is needed so we can fully utilize those advances, continuing to improve and advance flood risk identification.

Fourth, improvements in floodplain management and hazard mitigation elements of the NFIP should be continuously evaluated.

With respect to the current discussion draft, we find that the draft developed by this subcommittee includes a number of important and helpful changes for the short term to the NFIP, compared to the bill passed by the House last summer. We note that these constitute revisions rather than the full reforms that we are discussing, and we would urge that the subcommittee plan on an in-depth consideration of the significant policy and legislative recommendations for the NFIP during the 2- to 3-year reauthorization period.

ASFPM appreciates that the proposal attempts to modify and tighten previous proposals to delay the mandatory purchase requirement of properties in areas newly mapped as floodplains.

However, as a matter of principle, if the risk is known and documented, it is not appropriate for the Federal Government to help people ignore their risk. Rather than delay mandatory purchase, we prefer the subcommittee consider other methods of addressing the affordability issue, such as the means-tested voucher system to be handled by the Department of Housing and Urban Development.

I actually grew up in East St. Louis, Illinois, where my father owned a business. We lived and we worked in the floodplain with no real knowledge of the risk that we faced; we knew the levees were there, and we did count on them.

And to be abruptly confronted with the significant expense of flood insurance would have been very, very hard on my family and my dad's business. But to have had flood damages to our home and to the business that were uninsured, that we could not recover from, would have been devastating.

There are a number of aspects in the discussion draft that ASFPM agrees with, such as the proposal to use differentiated deductibles for pre- and post-FIRM properties.

The phase-in of actuarial rates for certain properties is a step forward, and we agree with most of the listed categories.

ASFPM very much supports the establishment of the Technical Mapping Advisory Committee, which should be an advisory council to provide stakeholder input to the needs and uses of the map, and to assist FEMA in improving its processes.

There are a number of issues that require further consideration. While ASFPM does support a more in-depth study of privatization, any such movement in this area must ensure that there are continued, strong incentives for comprehensive floodplain management, which is one of the great strengths of the current program.

Further, we would like to suggest two other studies, which would be in order, in addition to the privatization initiatives already provided for in the draft: first, a study of the feasibility of group insurance for entire communities, for identified flood hazard areas, or for residual risk areas behind levees; and second, an economic analysis of the overall effect on taxpayer funds of providing flood insurance vouchers to low-income property owners.

Also, the Severe Repetitive Loss Program is needed to assist in reducing the approximately $200 million drain on the National Flood Insurance Fund. And we urge the committee to work with FEMA to identify statutory-type changes to better implement this program and the use of demolish-and-rebuild as a mitigation option.

ASFPM is grateful for the opportunity to share our thoughts with the subcommittee, and hope they will be helpful as you move forward with legislation. We will be glad to respond to any questions, and to assist the subcommittee in any way we can. Thank you.

[The prepared statement of Ms. McConkey can be found on page 83 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Now, we will begin the question-and-answer period, and I recognize myself for 5 minutes.

Ms. Brown, over the past 5 years, FEMA has paid more than $2 billion in interest payments to service its debt, nearly $2 billion more to reduce it. But FEMA still owes $17.75 billion to U.S. taxpayers. Many have asserted that FEMA is unlikely to ever be able to repay its debt.

Do you foresee any scenario in which the debt can be paid, repaid over time? And can you outline a range of public policy options for how Congress might enable FEMA to be able to address its debt to the U.S. Treasury?

Ms. BROWN. We have looked at this issue. And the bottom line is, as it currently stands, FEMA has been able to make principal repayments, because they have experienced relatively low flood loss years. And that is how they have been able to do it.

It is not clear that it is reasonable to expect that to continue to occur in the future in order for FEMA to be able to make those payments. So, there is a possibility that in certain years where FEMA experiences higher-than-normal flood years, that they actually could see their borrowing from Treasury go up, because they may actually have to borrow from the Treasury in order to make their interest payment.

There are a range of scenarios that could be taken to address this. A decision could be made to forgive the debt in order to allow the program to start on a more sound financial footing, provided appropriate reforms are in place.

Another way to do it would be to consider a surcharge that FEMA could add to existing premiums, to be used to pay down the debt. That raises questions of fairness. Is it fair for the current and future policyholders to have to pay a surcharge to repay the debt?

So, there are many ways to think about it.

This is not something that we have specifically studied, but we have looked at and read a number of possible alternatives. But this is a challenge that has to be addressed in order for the program to be put on a more stable financial footing going forward.

Chairwoman BIGGERT. GAO has also suggested that operational and management issues may also limit efforts to address this, NFIP's financial challenges, and meet the program goals.

Can you highlight some of those issues for us?

Ms. BROWN. Yes. In the last decade, we have identified and made recommendations to address issues surrounding the rate-setting process and how that is handled. We have raised issues with the quality of the data that FEMA uses to do some of its rate-setting. We have raised concerns about the financial management controls and the system in place.

We have had findings surrounding the oversight of the Write Your Owns (WYOs). We have also looked at the incentive structure that FEMA uses to incent WYOs surrounding increasing the number of policyholders in the program and expanding the risk pool.

We have also, in the work that we currently have underway, we have identified a number of challenges associated with their information technology, and investments that they have made in a program, a technology program, that failed, that cost FEMA substantial sums of money.

So, human capital management, identifying where they need people, and a mechanism to make sure that the program is being adequately managed during emergencies and outside of emergencies, a full range of issues to be fully addressed.

Chairwoman BIGGERT. Thank you.

And then, Ms. McConkey, given your experience in Illinois, can you provide the committee with your point of view on risk-based pricing and how it should work, and also, alternatives that communities could consider for mitigating flood damage—or risk, I should say?

Ms. MCCONKEY. It is very important that the people who are living at risk, know the risk and share the—and be part of the paying for their risk. It is, we feel, inappropriate to externalize that risk to the rest of the taxpayers, the Federal taxpayers.

But we also understand that you have to gradually move towards actual rates for flood insurance, and that we also need to look at a more holistic view of our at-risk communities, and not just consider flood insurance, or just a levee to be the ultimate answer.

We need to look at really having more sustainable communities, which might include a strategic retreat from the floodplain, or buying flood easements, or other management techniques, mitigation techniques that will really, long term, reduce our flood risk in the Nation.

Chairwoman BIGGERT. Thank you. My time has expired.

I recognize Ranking Member Gutierrez for 5 minutes.

Mr. GUTIERREZ. Thank you very much.

I would like to yield my time to Congressman Cleaver.

Mr. CLEAVER. Thank you, Ranking Member Gutierrez. I do have some questions.

Ms. McConkey, you are a Midwesterner and grew up in the shadows of Missouri. We have had unusual snowfall this winter, which means that, very shortly, a mixture of the melting snow and the normal spring rain can and does often create flooding in Illinois and Missouri.

We are also still in the throes of a recession, in spite of good news from time to time, but we are still in the throes of a recession. And a large number of unemployed folk are living in areas that are susceptible to flooding.

Do you agree that it would be difficult for many of the people just struggling to exist, who did not purchase flood insurance, to have to go to a private insurer at a time like this?

There is a great deal of talking about the privatization and what does privatization do to people who are vulnerable, like those—you probably know some of them. Is it unfair for us to think in terms of privatization as a way for them to protect their homes and property?

Ms. MCCONKEY. Actually, what we believe is that, to deal with people with affordability issues, managed through a program like HUD, that has experience with means-tested systems, so that you could—

[laughter]

Actually, I can talk pretty loud.

[laughter]

We really think that it should not be handled through the insurance mechanism to deal with the affordability, that it should be through a means-tested program, like handled by HUD, where you would get vouchers if you cannot afford the flood insurance. That way, you have the protection of the flood insurance without distorting the insurance aspect of the program, and you have protection for individuals irrespective of if it is FEMA flood insurance, or if it is private flood insurance.

That is our solution.

I do not know how the rates would change with the privatization. I cannot speculate on that.

Mr. CLEAVER. No, it was not the rates as much as it is the fact that, I guess to some degree it is. But I am concerned about people who are just struggling right now to survive and are vulnerable.

Ms. MCCONKEY. Exactly.

Mr. CLEAVER. But before my time expires, I am from the Missouri side. My other concern, Mrs. Biggert—and I appreciate very much you moving ahead, trying to do something with regard to the flood insurance overhaul.

It seems to me, though, that there ought to be—and Mrs. Biggert asked you the question—maybe, if this bill moves—and I hope something moves, because I think we are dealing with an $18 billion problem, and the fact that we have people who are out here vulnerable.

And I would really hope that before September, we could come up with a bill, but that the legislation ought to address this $18 billion problem we have. I listened carefully to the options. None of them are extremely attractive, I might add.

But we have to do something, or we will continue to meet and talk about an $18 billion problem. And I think now is the time for us to attack the problem. I do not think we ought to wait.

And so, I do not know whether FEMA should send options, maybe even more that you did not mention, or some way we need to begin that struggle now, instead of postponing it.

I yield back the balance of my time.

Chairwoman BIGGERT. Thank you.

I think, Mr. Cleaver, that we really are having this hearing now, because we do need to move ahead. And we have expected having maybe another hearing, but at least a mark-up soon. This is a draft discussion right now, but we really wanted to proceed.

I know that the study is supposed to come out in June. But I think we really want to be moving ahead before then. And I think maybe we will get an update on all of what is going on as far as the study, too.

But it is very important that we do not let this slide. As you know, it is much harder to do it later on and get the Senate engaged, which has always been a problem.

[laughter]

You could say that.

I now recognize Mr. Hurt from Virginia for 5 minutes.

Mr. HURT. Thank you, Madam Chairwoman.

Thank you all for being here. Welcome. And thank you for your obviously significant interest in this important issue.

The chairwoman spoke of the $18 billion debt that has accrued through this program. And I have read that the deficit, the built-in deficit for this program annually has been $1.3 billion.

And Ms. Brown, I was wondering if you could talk about that deficit? Is that something that has been consistent post-Katrina, pre-Katrina? Are you able to comment on that?

Ms. BROWN. I am not. This is not anything that we have specifically looked at.

Mr. HURT. Okay. With respect to the proposal that we are evaluating, this draft bill, can you talk about what, in real terms, the taxpayer subsidy is for this program? Are you able to talk about that?

Ms. BROWN. Yes. I can give a rough estimate based on the full risk rates currently charged and the estimate for the subsidized amount. And the current estimate is that the subsidy basically results in those subsidized properties paying about 40 to 45 percent of the full risk rate.

We did a rough calculation based on the current policies in force, and estimate that somewhere around $1.8 billion a year is being subsidized. That is the amount that is lost in premiums, if there was a full risk rate—

Mr. HURT. And has GAO, in looking at this draft bill, been able to determine what that might be reduced to, if you are able to encourage the private market to come into this business?

Ms. BROWN. It depends on how that happened. The challenge with flood insurance has been, historically, there really was not a private market. And there was not a private market for a number of reasons.

So, depending on how that was structured to bring the private market in, there are a number of things that would have to be dealt with. If you bring the private market in, and they are able to focus on the lowest-risk properties, that would leave the program with a very concentrated risk pool. And all of the riskiest properties will be in NFIP. That can potentially expose the program to greater losses, because there would be this concentrated risk.

So, the impact that the private market would have is really unclear until there is a better sense of kind of how that would be structured and what role the NFIP would play in that particular scenario.

Mr. HURT. Okay. Obviously, one of the issues, a fundamental issue, I think, that we all have to kind of deal with—and this issue to me is a new one—is the issue of moral hazard. And obviously, I would think we probably all agree that there are places that people should not live.

Under the current proposal that we are looking at today, do you see that the moral hazard issue—that is, encouraging behavior, or encouraging people to do things that are not in their best interest—would that be minimized? Or could that be increased by the proposal that we are looking at today?

I would like an answer maybe from you, Ms. Brown, as well as you, Ms. McConkey, if you feel like it.

Ms. BROWN. The closer premiums come to fully reflecting risk is a clear signal to a property owner that they are living in harm's way. So, to the extent that the discussion draft moves those premiums in that direction, it definitely would help elevate the risk that homeowners and property owners are exposed to currently.

Mr. HURT. Ms. McConkey?

Ms. MCCONKEY. I do not think I could say it any better.

Mr. HURT. Okay. Thank you.

I yield back my time.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you, Mr. Hurt.

I now recognize Mr. Cleaver for his 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman.

I just have one question. Then I would like to yield the balance of my time to the gentlelady from New York, Mrs. McCarthy.

I am still on the $18 billion. And there have been some suggestions that perhaps reinsurance could be a way to eliminate future debt. I would like to just get your response to that, both of you.

Either of you?

One of you?

[laughter]

Ms. BROWN. The issue of reinsurance, one of the things in the discussion draft that was interesting is that there is an opportunity for FEMA to do some study and pilots, and explore the option of reinsurance.

This is something that we had looked at a couple of years ago. There did not appear to be an appetite at that time, but I think it is something that is definitely worth revisiting.

Because the way it currently works is, NFIP, while it is an insurance program, it does not function, really, anything like private insurance, because private insurers would purchase reinsurance to cover that catastrophic level of risk.

What happened—and we saw this happen in Katrina—because, to Representative Hurt's point, prior to Katrina, the program was not running a deficit, and it was pretty much self-funding up until 2005. And Treasury became the reinsurer, because any losses over and above the amount that could be covered through premiums, because there is no reserving mechanism, was borrowed from the Treasury.

And what you are left with is Treasury—the program now has this outstanding debt to the Treasury, because there was not the opportunity for any type of reinsurance mechanism.

Mr. CLEAVER. I yield to Mrs. McCarthy.

Mrs. MCCARTHY OF NEW YORK. I thank my colleague.

And may I also say thank you to the chairwoman for having this hearing. I think it is extremely important.

I just want to give you a little background. I live on Long Island, and we certainly have an awful lot of shoreline. So, obviously, we have a lot of homes that need flood insurance in case of a hurricane. And so far, we have been blessed that we have not had that hurricane.

But I represent center Nassau County. And I am sorry that Mr. Fugate is not here, because of questions that I had wanted to ask him.

But apparently, what FEMA had done was go out to Suffolk County, which has a higher level of flooding, even on heavy rains, and took those maps, and put them into Nassau County, the center of Nassau County, which they are saying that, on certain areas in this particular village were a little bit higher, even though we are not near any water.

And I stress that. We are not near any water, nor have any of the families had any floods for over 25 years.

Is there a possibility? Absolutely. Should we look at that? Absolutely.

But I guess the question I want to ask is, the draft legislation, which I agree on, contains a provision to bring back the Technical Mapping Advisory Council to address mapping standards, made up of representations from many different agencies familiar with mapping.

I am interested in getting your thoughts on having the mapping process in an entire independent entity in an effort to ensure that the most accurate data is used to update the maps. Nassau County and Long Island, we just had our maps updated.

Just to give you a sidebar, I have a retirement home somewhere out in Suffolk County, very close to the water. I did not get an increase. I am not now in a flood zone. And I do not understand that at all, because when it rains heavily, the water from the bay comes up, basically on the lawn.

So, something is wrong here. If I am living there, then I should be paying more, in my opinion. I shouldn't say that, but right now, I am getting away with it.

But the people in Nassau County, in the center, in my opinion, the maps are wrong. So, I would like your opinion on bringing back the Technical Mapping Advisory Council, so that we have more accurate maps.

Ms. MCCONKEY. We very much endorse the idea, the concept of bringing back the Technical Mapping Advisory Committee. Actually, when it was instated in, I think it was 1994 or 1995, through their recommendations, they actually brought out the Map Modernization Program, which has really led to great progress in improving the quality and the accuracy of the maps—in most places.

So, yes, we do believe that is an important body to have as an advisory council.

Through FEMA's Risk MAP Program, their next 5-year initiative, they have taken certain very strong steps to address quality issues with the mapping, and also to have greater engagement with the community, so that there is more ground truthing to what they are doing earlier on in the process.

And so, I—

Mrs. MCCARTHY OF NEW YORK. May I stop you right there? That was one of their biggest failures. They did not let the community know. They did not let even the counties know. They just asked them for their old maps, which is very upsetting.

Ms. MCCONKEY. FEMA has addressed a lot of problems in that regard with their Risk MAP process, where it is very clearly prescribed to anyone who—and actually, the group that I manage, we do the digital flood insurance rate maps. We do the engineering studies for Illinois counties. We have done 78 of our 102 counties. So, we are actually—I am involved in that process.

I read the rules, because that is what we are supposed to do. And through the Risk MAP process, there really is strong community engagement, early on technical meetings, so that there is ground truthing of what you are doing. And then, FEMA has also set up—and I apologize, I may not have the right phrase—but sort of an arbitration, an independent arbitration panel, for when there are appeals to the maps.

So, I think they have listened. They have heard about these problems, and that Risk MAP makes great strides in addressing the accuracy and the outreach issues.

Mrs. MCCARTHY OF NEW YORK. Thank you.

Ms. Brown, anything?

Mr. Cleaver, would you like your time back?

Chairwoman BIGGERT. I think his time has expired.

Mrs. MCCARTHY OF NEW YORK. Oh, sorry.

Chairwoman BIGGERT. I now recognize Mr. Dold from Illinois for 5 minutes.

Mr. DOLD. Thank you, Madam Chairwoman.

Ms. McConkey, we are delighted that you are here from Illinois. Obviously, the chairwoman, ranking member, and myself were delighted to have another person from Illinois here on the panel. So, thank you so much.

Ms. MCCONKEY. Thank you very much for the invitation.

Mr. DOLD. Ms. Brown, in the past you have noticed that Congress has noted that repetitive loss properties constituted a significant drain on the NFIP. Do you have any suggestions on the repetitive loss properties and how to make them less of a liability?

Ms. BROWN. Yes. This is also an issue that we have looked at over time. And while great strides were made with amendments that were made in the 2000s to address repetitive loss properties, the number of properties has continued to increase. And we looked at February numbers, and they are continuing to increase.

There are a couple of things that we would propose be considered that deal with mitigation offers and what happens when those offers are refused or not responded to, and in terms of allowing FEMA, perhaps, the authority to apply a surcharge above a—rate for those properties, if the homeowner chooses to refuse or not respond to an offer.

And also, really focusing some attention on the mitigation programs and determining if there are ways to make them more efficient and effective as a way to address the issue of the repetitive loss properties.

Mr. DOLD. And just following up on my colleague on the other side who had talked about reinsurance, you currently are not using reinsurance right now. Is that correct?

Ms. BROWN. In FEMA? No.

Mr. DOLD. They are not using it. Is there any question that you are able, that FEMA is able to use it?

Ms. BROWN. That I am not sure about, if they could if they wanted to. Right now, the mechanism is for them to rely on borrowings from Treasury.

Mr. DOLD. Would, perhaps, additional insight or authority from Congress be necessary to let them do that? It is certainly a common practice out there in the insurance industry, in order to try to protect from catastrophic losses.

And certainly, when we look at those areas that are particularly hard-hit, or those that continue to be hit again and again, it would seem to me that, potentially, at least having the mechanism or vehicle available may be something that they might want.

Is that something—what is your take on that?

Ms. BROWN. My take on whether they could do it now, this is why I really wish Mr. Fugate was here to address that question specifically.

But in terms of that being an option to be considered, I think that is definitely one of the options that needs to be on the table and discussed in terms of reforming the program going forward.

Mr. DOLD. Okay.

And, Ms. McConkey, a question for you on the vouchers. You had talked a little bit about vouchers before. Can you give me any sort of an idea on how you anticipate, or how you would like to see something like this, how it would be administered? And do you have any idea what the costs of that would be?

Ms. MCCONKEY. To answer your last question first, no. The cost of it is a study that we recommend be initiated through this draft legislation.

The voucher system we envision as something to be managed through the Department of Housing and Urban Development, because they have experience with means-tested voucher systems. FEMA does not.

But this way, it would allow for people to get the message about the risk that they have with their home, and yet not be burdened in these times, or because families who really are just operating on the edge would not be burdened with the cost, that we would pick that cost up.

It also provides them with fuller protection than no insurance at all. If you have insurance, then that means you have money to pay off your mortgage. But if you were relying on disaster assistance, you are still obligated for that mortgage. You really are not covered.

So, it really provides lower-income people with greater coverage. The voucher system, as we said, we believe it should be means-tested. And that is the extent of my knowledge on that. We would have to do some more research to give you a more thorough answer.

Mr. DOLD. Okay. And with just the short amount of time that I have left, you talk in your testimony before about—or at least in testimony in the past—about floodplain coverage going from the 100-year to potentially expanding it beyond that in terms of a 250- or even a 500-year event.

Do you have any idea how much of the country would be covered under those instances?

Ms. MCCONKEY. That is something that I don't think that anybody could just estimate without some research on it.

Going beyond the 100-year, looking at the 500-year, would be something to consider as a residual risk area. Probably, you could estimate the amount of floods—the difference between 100-and 500-year floodplain acreage, based on current FEMA mapping, if it was all digital. You might be able to get some estimate.

Chairwoman BIGGERT. The gentleman's time has expired.

Ms. Capito, do you have any—

Mrs. CAPITO. Thank you, Madam Chairwoman. I think I will save my questions for the second panel. Thank you.

Chairwoman BIGGERT. Mrs. McCarthy, would you like to claim your time?

Okay. Then we will go to Mr. Palazzo from Mississippi.

Thank you for joining us.

Mr. PALAZZO. Thank you for having me.

Good morning. I appreciate the courtesy provided by the House Financial Services Committee to allow me to participate in this morning's very important hearing.

Thank you, Chairwoman Biggert. I ask consent that my full statement be included in the record.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. PALAZZO. I represent Mississippi's 4th Congressional District, which is the only district representing the Mississippi Gulf Coast.

FEMA has served as a partner to our State, and we applaud Administrator Fugate's continued leadership to the agency. The National Flood Insurance Program is critically important to South Mississippi and any area exposed to flood risk.

As floods continue to be among the most costly natural disasters in the United States, I urge the committee to closely consider reforms offered by Administrator Fugate to the NFIP, and to pass a long-term reauthorization of NFIP.

Madam Chairwoman, in the absence of Administrator Fugate, I would like permission to submit my questions for the record to him.

Chairwoman BIGGERT. Without objection. All members' requests for questions will be put in the record.

Mr. PALAZZO. Thank you.

I would also be remiss if I did not mention that the high cost of wind insurance is a major factor preventing coastal residents from building homes and attracting new industry. I am committed to a bipartisan effort to resolve this with the goal of providing coastal residents with needed cost relief and comprehensive coverage.

I look forward to working with the Financial Services Committee to find solutions to our problems.

Thank you again, Chairwoman Biggert, for allowing me to be here today, and I yield back.

Chairwoman BIGGERT. Thank you.

Mr. Duffy, do you have any questions? Or we will move to the next panel.

I would like to thank the witnesses. This has been very informative and very helpful to us. And thank you so much for being here.

Ms. MCCONKEY. Thank you.

Ms. BROWN. Thank you.

Chairwoman BIGGERT. And I might—for those members who will have written questions, the record will be open for 30 days for submitting questions for written response.

And we will now move to the next panel.

If we can do this very quickly, I might mention that the Floor is estimating that we will have votes between 11:45 and 12:15, so, we do want to move as expeditiously as possible.

If the panel can take their seats, and they know where they are sitting?

All right. I would like to introduce our second panel:

We have Stephen Ellis on behalf of the SmarterSafer Coalition, and vice president, Taxpayers for Common Sense in Washington, D.C.

Then, we have Terry Sullivan, chair of the Committee on Flood Insurance, National Association of REALTORS®, and owner of Sullivan Realty in Spokane, Washington.

Spencer Houldin, chair, Government Affairs Committee, Independent Insurance Agents and Brokers of America; and president, Ericson Insurance Services in Washington Depot, Connecticut.

Frank Nutter, president, Reinsurance Association of America, Washington, D.C.

Sandra Parrillo, chair of the National Association of Mutual Insurance Companies and president and CEO of Providence Mutual Fire Insurance Company, Warwick, Rhode Island.

Then Donna Jallick, on behalf of the Property Casualty Insurance Association of America and vice president, Flood Operations, Harleysville Insurance, Harleysville, Pennsylvania.

And last but not least, Barry Rutenberg, first vice chairman, National Association of Home Builders, Washington, D.C.

Welcome to you all. As you heard, I am sure, please limit your testimony to 5 minutes. And after that, we will have the question-and-answer period.

So, Mr. Ellis, if you would like to begin for 5 minutes, you are recognized.

STATEMENT OF STEPHEN ELLIS, ON BEHALF OF THE SMARTERSAFER COALITION, AND VICE PRESIDENT, TAXPAYERS FOR COMMON SENSE

Mr. ELLIS. Thank you. Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. I am Steve Ellis, vice president of Taxpayers for Common Sense, a national, nonpartisan budget watchdog.

Thank you for inviting me here today to testify. I would also like to recognize the people who are affected by the tsunami, and also how it accentuates the importance of both FEMA and the National Flood Insurance Program.

Taxpayers for Common Sense has long advocated for reform of the National Flood Insurance Program. And with only $3 billion in annual revenues offsetting the $18 billion the program is in debt to Treasury, all have recognized NFIP is fundamentally flawed and must be reformed. The question is: How?

Any reauthorization of the National Flood Insurance Program must make significant changes to put it on sounder financial footing with more actuarially sound rates and accurate maps.

The discussion draft of the reform legislation being circulated by the committee is a good start. It responsibly tackles rate and subsidy issues, creates a mechanism to increase confidence and accuracy in flood mapping, and does not stick taxpayers with the tab of bailing out a failed program.

However, we are concerned with concerned with provisions that could inhibit adoption of updated maps, add a new business line to the program and mandate annual coverage limit increases that will ensure the program's liabilities actually increase each year. We look forward to making this good start an even better final product.

TCS is allied with SmarterSafer.org, a coalition of free market, consumer, environmental, insurance industry, and taxpayer groups in favor of environmentally responsible, fiscally sound approaches to natural catastrophe policies that promote public safety. The depth and breadth of the coalition, some of which are at this table, underscores the importance of reforming NFIP.

I would like to submit for the record SmarterSafer.org's principles for reform.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. ELLIS. But to summarize quickly and clearly, those principles are: maps are accurate and up-to-date; there are risk-based rates; any subsidies should be explicit and targeted only to those who truly need them; and mitigation is encouraged as a tool to reduce risk. Taxpayers for Common Sense strongly endorses those basic principles to better protect people, property, the environment, and the taxpayer.

I would now like to talk about flood insurance and the draft legislation from the taxpayer perspective.

NFIP does not charge truly actuarially sound rates. 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 and of itself, especially since the loans are virtually interest-free. The program contains an enormous cross-subsidy as well.

The draft legislation will provide a mechanism to move towards more actuarially sound rates for many properties. The graduated phase-in of rates for newly mapped areas are responsible both for the homeowner and the programs. The legislation also stipulates that most properties have their rates increase by 20 percent annually until they are paying the estimated risk premium rate.

In addition, the draft legislation directs that subsidies not be available to lapsed policies.

These changes move the program in the right direction. What appears to remain unchanged are subsidies to pre-FIRM and generally repetitive loss properties that do not meet any of the specific criteria. It is not clear how many properties or the potential loss that this represents, but it is an area that must be reformed. These properties have been subsidized for decades.

The Nation's floodplains are dynamic. Shifting from the impact of development, weather patterns, and topographical changes, flood maps must be up-to-date, accurate, and based on the best available science.

We support the envisioned Flood Mapping Advisory Council to develop new standards for flood insurance rate maps that will incorporate true risk, be graduated, and reflect realities on the ground, both man-made and natural.

The direction at FEMA that implements the new protocols is also critical. The council and the development of new mapping standards should not, and will not, delay the ongoing FEMA map modernization efforts. That program is critical to the long-term fiscal viability of the program.

We appreciate that, unlike previous legislation, the bill does not automatically delay the implementation of new maps or slow walk rate increases. However, the draft legislation could delay or undercut new maps by giving the administrator authority to suspend flood insurance purchase requirements for newly mapped Special Flood Hazard Areas.

Insulating people from the changes related to the maps on paper does not change the geological realities. Their property is at risk.

There are some troubling expansions in the draft. One is the creation of a new insurance product for business interruption, and another, the loss of use of a personal residence. Another would enable coverage limits to annually increase by some inflationary measure.

With the flood insurance program so heavily in debt, it does not make sense to expand the coverage provided.

TCS supports the privatization study called for in the legislation and encourages FEMA to pursue the private risk management initiatives. Also, FEMA should be authorized to develop a catastrophic reserve.

Communities and individuals should be helped to reduce their flood vulnerability, including stronger standards for floodplain management and mitigation.

On balance, the draft legislation is a good step forward to reform the troubled Flood Insurance Program. We look forward to working with the committee and Congress to move the program in the right direction and off the backs of taxpayers.

Thank you.

[The prepared statement of Mr. Ellis can be found on page 67 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

Mr. Sullivan, you are recognized for 5 minutes.

STATEMENT OF TERRY SULLIVAN, CHAIR, COMMITTEE ON FLOOD INSURANCE, THE NATIONAL ASSOCIATION OF REALTORS® (NAR), AND BROKER/OWNER, SULLIVAN REALTY

Mr. SULLIVAN. Thank you.

Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and subcommittee members. Thank you for inviting me to testify today regarding legislation to reform the National Flood Insurance Program.

My name is Terry Sullivan. I am the designated broker of Sullivan Realty in Spokane, Washington. I have been active with the National Association of REALTORS® for the last 17 years of my 40-year career as a REALTOR®.

Currently, I serve as chair of NAR's Land Use Committee. I am honored to represent the views of more than 1.1 million REALTORS® engaged in all aspects of residential and commercial real estate.

As you know, flooding claims more lives and property than any other natural disaster in the United States. It happens anywhere, along rivers where snow melts or rain falls, as well as the coastlines. Without the National Flood Insurance Program, 5.6 million home and business owners across the United States would not have access to affordable flood insurance.

Since the year 2000, the program has averted $16 billion in property loss in the 21,000 communities where flood insurance is required. In short, the program saves taxpayers money.

Chairwoman Biggert, thank you for your leadership and for drafting the legislation to reauthorize the NFIP for 5 years. This would end the current stop-gap approach that has led to nine extensions and five lapses in the program since 2008. A 5-year reauthorization would provide needed certainty for the real estate markets to recover from the longest recession since the Great Depression.

The many extensions and shut-downs have immeasurably undermined real estate and investor confidence. Just one of the lapses delayed or cancelled more than 47,000 home sales in June of 2010 alone.

We are pleased to see the bill would add coverage options for business interruption and loss of residential use. Coverage which has been updated since 1994 would be indexed for inflation.

Finally, the bill would ensure that repetitive loss properties have an insurance rate that reflects their loss history, a provision we strongly support.

All of these reforms will encourage participation, increase the funds for NFIP, help property owners recover from flooding, and decrease future Federal assistance when underinsured properties suffer flood loss.

While we understand the need for tough reforms to strengthen the program long-term, we remain deeply concerned about provisions to return to a time when taxpayers relied on private insurers to administer the program. It did not work then, and it would not work now.

Madam Chairwoman, this is HUD's Federal Register notice from 1977. It provides the history of NFIP and how we got to the government program we have today. With your permission, I would like to have it included in the record along with my written statement.

NAR is strongly opposed to the private risk initiatives or bills, including H.R. 435, to end the NFIP.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. SULLIVAN. Thank you.

The bottom line is the private market will charge too much. Today, the 4 companies that write only 200,000 private policies would have to ramp up by 3,000 percent to the NFIP's 5.6 million current policies. The private insurance markets simply cannot guarantee either affordability or availability of flood insurance.

In conclusion, NAR believes that Congress should reform the program, not end it.

Once again, on behalf of the entire membership of the National Association of REALTORS®, thank you for providing us this opportunity to share our views on a vital program, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Sullivan can be found on page 137 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

And now, Mr. Houldin?

STATEMENT OF SPENCER HOULDIN, CHAIR, GOVERNMENT AFFAIRS COMMITTEE, INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA (IIABA), AND PRESIDENT, ERICSON INSURANCE

Mr. HOULDIN. Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee.

My name is Spencer Houldin, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America, known as the Big "I," to present our association's perspective on extension and reform of NFIP.

I am the president of Ericson Insurance, a second generation insurance agency with offices in Connecticut and New York.

Since 2008, I have served as chairman of the Government Affairs Committee for the Big "I," and have represented the State of Connecticut on the Big "I's" board since 2006.

The Big "I" is the Nation's oldest and largest trade organization. An association of independent insurance agents and brokers, we represent a national network of more than 300,000 agents, brokers and employees.

Many of these agents serve as a sales force for NFIP, working with the Write Your Own companies. 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.

We think this hearing is especially timely, in light of severe storms and flooding that are currently occurring in the Northeast and this morning's events on the West Coast. In fact, my firm fielded nearly 75 calls this week when clients experienced water in their homes up in Connecticut.

We commend the subcommittee for looking at this very important issue.

The Big "I" believes that the NFIP provides a vital service to people and places that have been hit hard by 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 this program in 1968, the only financial remedy available to consumers after flooding was Federal disaster assistance. Since then, the NFIP has filled the private market void and created a reliable safety net.

It is also important to note that for 2 decades, up until the 2005 hurricane season, the NFIP was self-supporting.

With that said, we do recognize that the program is far from perfect, and calls for Congress to shore up its financial situation.

For this reason, the Big "I" is very encouraged by Chairwoman Biggert's draft legislation, the Flood Insurance Reform Act of 2011. In the past, the Big "I" has released a 12-point plan to modernize the flood program, and we are happy to see that a number of these recommendations have been incorporated in the proposed legislation.

The first of these is a long-term reauthorization, which we strongly support. As you know, in recent years Congress has relied on numerous short-term extensions. Last year alone, the NFIP expired on three separate occasions, only to be retroactively extended by Congress each time.

While the Big "I" is grateful for this action, we strongly believe that long-term extension is critical to provide marketplace stability.

Additionally, for many years the Big "I" has asked Congress to begin phasing out subsidies found in the program. We are pleased that Chairwoman Biggert's draft legislation addresses this for many properties.

The Big "I" welcomes and supports Chairwoman Biggert's ideas on phasing out subsidies for commercial building, second and vacation homes, homes experiencing significant damage or improvements, repetitive loss properties, and homes sold to new owners.

Additionally, the Big "I" welcomes the draft legislation's proposal to increase the amount FEMA can raise premiums in any given year. Currently, FEMA can only increase a premium a maximum of 10 percent on a property. The draft legislation would propose to increase this to 20 percent, which would allow the program to move even more properties towards actuarial rates.

The Big "I" is also pleased that the draft legislation has chosen to modernize NFIP by increasing maximum coverage limits by indexing them for inflation, and by allowing FEMA to offer the purchase of optional business interruption and additional living expense coverage. The inclusion of optional business interruption coverage is particularly important to Big "I" members and their commercial clients, because it reimburses them for lost income due to their inability to operate due to flood loss.

As I speak, we have a popular rib restaurant in my town that has been shut down since Monday. Their property was flooded, as was the road in front of their business. They are losing thousands of dollars a day in revenue. But still, their normal expenses, including payroll and mortgage, continue.

It is an uninsurable loss today, and one that is detrimental to a small business. With another 2 inches of rain last night, there is a good chance they will not be open for another week.

The Big "I" also supports strongly the option for a consumer to purchase additional living expenses. If their home is not habitable due to a flood loss, they need funds to provide alternative living arrangements.

In closing, the Big "I" is very pleased that the subcommittee is conducting today's hearing, and appreciative of the opportunity to testify. Adopting the reforms found in the draft legislation would help make the NFIP more actuarially sound and more effective at serving both consumers and taxpayers.

Thank you.

[The prepared statement of Mr. Houldin can be found on page 74 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Houldin.

Mr. Nutter, you are recognized for 5 minutes.

STATEMENT OF FRANKLIN W. NUTTER, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA (RAA)

Mr. NUTTER. Thank you, Madam Chairwoman. My name is Frank Nutter, and I am president of the Reinsurance Association of America.

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 their financial performance, enhance financial security and reduce financial volatility.

It can serve the same function for the National Flood Insurance Program.

As it currently operates, the NFIP is not an insurance program. But it should be, and it 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.

It is a commonly held belief that a private sector risk-bearing role in the NFIP is unachievable. On behalf of our community, the reinsurance community, we would challenge that suggestion.

We commend the Chair's discussion draft regarding protecting taxpayers with risk-based rates. The subsidized rates were introduced early in the program as an inducement for communities to come into the program, and it was a successful strategy. But the number of subsidized properties has actually risen in recent years.

In addition, the subsidized rates have facilitated the development of environmentally sensitive coastal areas, including those at high risk to flood loss, and compromised the use of the natural floodplain to mitigate damage.

Repetitive loss properties, according to the GAO, account for only 1 percent of the policies, but 25 to 30 percent of the losses.

In addition, statutory caps on rates may be popular with beneficiaries, but the caps distort risk assessment by builders, local officials, property buyers, and policyholders. And they increase the cross-subsidy from low- or no-risk persons and taxpayers to those living in high-risk flood areas. And again, we commend the draft in this regard.

The NFIP should plan for extreme events, but does not. 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, but relies on the average annual loss model for its pricing.

This 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 for, nor priced for extreme event years.

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.

The private sector role in the program now is appropriate, and it relates to the Write Your Own program, which has provided the

NFIP with a valuable marketing arm and administrative capability.

For a variety of reasons, a private insurance market for flood risk has not developed. We believe, however, that a private reinsurance risk-bearing role for the NFIP can be established, and that the NFIP can address its volatility and extreme event exposure and reduce the dependence on taxpayers and the Federal debt through risk transfer to reinsurance and private capital markets.

Both financial sectors have significant capacity and believe flood risk can be reinsured or transferred. Such a transfer introduces a private sector rating verification model into the NFIP, thus providing an incentive and guidepost for risk-based rates.

We have offered two approaches to do this. The first is a traditional, transactional reinsurance approach. As with most State property insurance plans, fair plans and windstorm pools, nearly all private insurers address their volatility through the purchase of reinsurance.

As with these other governmental entities and private sector insurers, the NFIP would work with modelers, underwriters, and brokers to provide the market with an evaluation of its risk portfolio, determine what types of risk are amenable to risk transfer, and then seek coverage in the private sector.

Should the NFIP find the bids unattractive on a price or coverage basis, it would not go forward with the placement. The NFIP, therefore, would 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.

As is reflected in the discussion draft, no study is necessary to evaluate this alternative, but it can be pursued at this time with a full opportunity to evaluate proposals.

The second option that we have highlighted exists in the current draft, and that is the reauthorization of a reinsurance pool.

Section 4011 of the NFIP legislation adopted in 1968 provides for the Director of FEMA to encourage and arrange for appropriate financial participation and risk-bearing by insurance companies, to assist insurers to form, associate or join a pool, on a voluntary basis, for the purpose of assuming, on such terms as may be agreed upon, financial responsibility as will enable such insurers, with Federal financial assistance, to assume a reasonable portion of responsibility for claims under the Flood Insurance Program.

The provisions of the statute authorizing the pool have long been dormant, yet they remain a viable mechanism for the creation of another pool, this time to reinsure the National Flood Insurance Program, capitalized by those insurers that voluntarily wish to provide capacity. The Director and those participating insurers would enter into negotiations over the risk-sharing formula, and could individually subscribe capacity on an annual basis.

This proposal does not change the Write Your Own program. FEMA remains the insurer of the flood risk at the consumer level. But it 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 reinsurance program and/or the reauthorization of the standing facility—are both complementary and not exclusive to each other. The existing statutory authority may well be sufficient to move forward without delay.

We look forward to working with the committee and the Congress on the reform to the Flood Insurance Program, and the reintroduction of a private sector reinsurance role in it.

Thank you.

[The prepared statement of Mr. Nutter can be found on page 102 of the appendix.]

Chairwoman BIGGERT. Thank you very much.

Ms. Parrillo, you are recognized for 5 minutes.

STATEMENT OF SANDRA G. PARRILLO, CHAIRMAN, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC), AND PRESIDENT AND CEO OF THE PROVIDENCE MUTUAL FIRE INSURANCE COMPANY

Ms. PARRILLO. Thank you. Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for the opportunity to speak here today.

My name is Sandy Parrillo, and I am president and chief executive officer of the Providence Mutual Fire Insurance Company, one of our Nation's oldest insurance companies.

We began as a small fire insurance mutual in 1800, and today provide personal and commercial insurance protection to more than 65,000 policyholders in New England, New York, and New Jersey. The Providence Mutual employs approximately 75 individuals, is represented by more than 300 independent agents, and is based in Warwick, Rhode Island.

I am here today as chairman of the National Association of Mutual Insurance Companies to present our views on the National Flood Insurance Program. NAMIC represents more than 1,400 property and casualty insurance companies ranging from small farm mutuals, to State and regional insurance carriers, to large national writers.

NAMIC members serve the insurance needs of millions of consumers and businesses in every town and city across America. Collectively, NAMIC members cover more than 50 percent of all homes in the country.

I would like to begin by thanking the committee for its hard work on producing a discussion draft of proposed reform legislation. We are encouraged that the draft reflects the input of many of the relevant stakeholders, and has the stated goal of protecting taxpayers and policyholders.

It is our opinion that the NFIP is in serious need of reform. In order to achieve this goal, NAMIC believes that the best option is optimizing the current framework by implementing significant reforms that address the existing weaknesses.

The program's flaws are significant. Subsidized premiums have been charged on a non-actuarial basis. Some estimates of the subsidies are as high as 60 percent.

This has been incentivized poor land use and over-development near desirable waterfront locations. In addition, the take-up rates for those in need of coverage remain extremely low. Under 30 percent of those who need flood insurance purchase it.

The NFIP was created in 1968, because of the absence of a viable private flood insurance market. The unconventional nature of flooding 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 public-private partnership that eventually emerged between the Federal Government and the Write Your Own companies has the potential to offer an answer to a seemingly insoluble problem.

We believe that, with the right mix of reforms, the program can begin to address the problems of adverse selection, moral hazard and financial instability that has plagued it in the past.

We recommend a package of key reforms designed to achieve five essential objectives.

First, to charge actuarially sound rates. The NFIP must begin charging risk-based rates, if it is to have any chance of being a solvent program. These rates should reflect the true cost of providing coverage. Under the current structure, there is no chance that the program will ever repay the sizable debt it accumulated in 2005.

We recognize that the move to actuarially sound rates is likely to be painful, due to the higher premiums that will have to be charged in some instances. For those property owners who need assistance, flood vouchers might be offered on a means-tested basis to help mitigate the cost.

However, 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 and costs of where they live.

Second, 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. Putting off the adoption of updated flood maps does a disservice to those citizens, property owners, rescue workers and land development officials living and working in flood-prone areas, who, in the end, risk losing their homes and their lives. We recommend adopting a non-political, balanced and credible process for updating the maps.

Third, to improve the take-up rates. Insurance is inherently dependent upon the law of large numbers. Thus, the insurance mechanism works best and is the most affordable when everyone participates in the program.

Currently, only 20 to 30 percent of individuals exposed to flood hazards actually purchase insurance. The program must take steps to increase these numbers dramatically in order to properly pool the flood risk and achieve financial soundness.

Fourth, discourage repetitive loss properties. According to the CBO, there are currently 71,000 NFIP-insured repetitive loss properties, which represent just 1.2 percent of the NFIP portfolio, but account for 25 to 30 percent of the total claims paid between 1978 and 2008.

Something must be done to deal with this issue. Quite simply, American taxpayers should not be forced to subsidize a small subset of NFIP policyholders who continue to rebuild in high-risk areas.

Finally, improve the management and correct operational inefficiencies. The NFIP must have quality information regarding its policyholders if it is to operate efficiently. We must develop and institute clear procedures for monitoring contracts and claims records, effectively communicating with lenders, and triggering enforcement actions for non-compliance with mandatory purchase requirements.

We believe these reforms are necessary and achievable. I have included more detailed policy proposals for each of our five key objectives in my written testimony. And as the process moves forward, we stand ready to work with the subcommittee to address the insufficiencies in the current program.

Again, thank you for the opportunity to speak here today.

[The prepared statement of Ms. Parrillo can be found on page 112 of the appendix.]

Chairwoman BIGGERT. Thank you.

And Ms. Jallick, you are recognized for 5 minutes.

STATEMENT OF DONNA M. JALLICK, ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI), AND VICE PRESIDENT, FLOOD OPERATIONS, HARLEYSVILLE INSURANCE

Ms. JALLICK. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee.

Thank you for the excellent draft legislation on flood reform. The proposed changes address many of the major flaws in the current program.

Thank you also for considering it in a timely fashion; 5.6 million people depend on this program to protect their homes and businesses. And thank you for the bipartisan leadership you have demonstrated on flood reform over the last several years.

My name is Donna Jallick. I am the vice president of flood operations for Harleysville Insurance, one of the largest Write Your Own flood insurance private partners. Harleysville is also a member of the Property Casualty Insurers Association of America and the Write Your Own Flood Insurance Coalition.

I have been working with the Federal flood program for 15 years. Last year, Congress allowed the NFIP to expire 4 times for a total of 53 days. And there have been 10 short-term extensions in less than 3 years. Lapses hurt consumers, millions of real estate professionals, and our business.

Private Write Your Own insurers have been leaving the program in droves, in part because of the lack of stability in the program and the confusion for consumers. When the program lapses, insurers have to decide whether to keep collecting flood premiums and whether we can afford to put our name behind a program that may or may not be continued in the same form by Congress. It creates significant liability and vulnerabilities for all stakeholders.

The lack of program stability also makes it difficult to administer the program and to explain it to consumers. Our disconcerting message must be: buy flood insurance, because we think the program will be renewed. And we have a guess as to what we think the rates might be when it gets extended retroactively.

We already require agents to spend months training to understand and explain the NFIP to consumers. Lapses and short-term extensions increase this expense.

Five years is a good proposed extension.

The available amount of protection for consumers under the flood program has not been increased for 17 years. The draft would index flood coverage for inflation. That is a good start.

Federal flood rates, which are currently a fraction of what the private market would consider, even for low-risk properties, would be appropriately increased under the draft legislation.

Rates for coverage in many high-loss and environmentally sensitive areas would particularly be increased closer to expected loss costs. This approach still leaves a government subsidy, but is a very good start toward reducing that subsidy, and it is a proposal that we strongly support.

We also applaud the proposal to consumers by adding living expenses and business interruption to the available coverage. People forced from their homes need immediate cash for shelter. The proposal makes Federal flood coverage more closely near private coverages that protect individuals and business consumers, and helps them move forward quickly.

Just as important as the good provisions in the bill is streamlined operations. The number of private insurance partners serving consumers in the flood program has dropped from 150 to 70 that are actively writing flood insurance over the last 6 years.

While Harleysville has worked very hard to provide our policyholders with affordable protection, for many insurers, program revenues have been outweighed by growing administrative costs. They are leaving the NFIP.

The draft does not add too many additional requirements to the NFIP. Please keep the bill streamlined to ensure the program will remain standing.

Thank you for the bipartisan committee's draft, which addresses the critical vulnerabilities in the NFIP, and will greatly strengthen flood protection for millions of consumers. The Write Your Own flood partners support you, and hope that you will be able to keep a straightforward bill with long-term extension and no further lapses.

Harleysville and PCI stand ready to be of any assistance desired.

[The prepared statement of Ms. Jallick can be found on page 80 of the appendix.]

Chairwoman BIGGERT. Thank you.

And finally, Mr. Rutenberg for 5 minutes.

STATEMENT OF BARRY RUTENBERG, FIRST VICE CHAIRMAN, THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

Mr. RUTENBERG. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, 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 of directors of the National Association of Home Builders.

NAHB commends the subcommittee for addressing reform of the NFIP. Builders strongly support a 5-year program reauthorization as the best way to provide a steady foundation on which to build program revisions and ensure that NFIP is efficient and effective.

For several years, NFIP short-term extensions have created a high level of uncertainty in the program, causing severe problems in already troubled housing markets. During these periods, there were delays or canceled closings due to the inability to obtain 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 this 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 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 the home lies in or near a floodplain.

Home 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.

The 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 constituents and consumers.

Unfortunately, the losses and devastation suffered with the 2004 and 2005 hurricanes and the 2008 Midwest floods have 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 these historic circumstances. The NFIP is not just about flood insurance premiums and pay-outs, but the broad program that guides future development and mitigates future losses.

A financially stable NFIP is in all of our interests, and Congress' 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 right 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 are not using the updated data. Because of this, large discrepancies remain.

We believe continued congressional oversight is necessary. We commend the proposal to establish the Technical Mapping Advisory Council, and hope it will foster more collaboration.

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 types 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. Should Congress change the Special Flood Hazard Area from a 100-year standard to a 250-year standard, it would require more homeowners to purchase flood insurance and would impose mandatory construction requirements that increase costs and impact resale values significantly.

This would also affect FEMA by requiring modifications 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. NAHB looks forward to working with the committee on this valuable program.

[The prepared statement of Mr. Rutenberg can be found on page 122 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Unfortunately, if you look at the clock and you see those two white dots up there, that means that we have votes, and we have about 7 minutes left for voting. These Floor votes may take 45 minutes to an hour, but we do want to have the opportunity to ask questions. I hope all the members will come back, briefly.

So, the subcommittee stands in recess and will convene immediately following the Floor votes.

[recess]

Chairwoman BIGGERT. The committee will reconvene. Now, we will get started, so that we do not delay you any longer than necessary.

And I will recognize myself for 5 minutes.

Mr. Nutter, first, do you believe that the private reinsurance market has a willingness to provide reinsurance of the NFIP's flood risk?

And second, to put together a reinsurance program for NFIP to place in the reinsurance market, what data would be appropriate for FEMA to provide? And is that really necessary?

Mr. NUTTER. Madam Chairwoman, the reinsurance market is very interested in exploring this with the NFIP. The reinsurance market routinely provides reinsurance for insurance companies, but it also provides it for other government-related programs. The California Earthquake Authority buys something like $3 billion a year in reinsurance capacity. State wind pools do.

So, there clearly is an appetite and a desire to look at catastrophe risk. It is a common use of reinsurance.

I will supply for the committee's staff, if you would like, a more detailed set of metrics that would be appropriate for this.

And what I would say is that you would expect that the program, working with the private sector, would want information related to the types of properties that are insured, the insured values, any mitigation in the area—the kind of things that even the layman would understand would be necessary to fully evaluate the risk—and then to make a recommendation to FEMA and the NFIP about how to structure a program that would be successful when placed in the market.

Chairwoman BIGGERT. Please submit for the record the data that is—

Mr. NUTTER. Thank you. I will.

Chairwoman BIGGERT. Without objection, it is so ordered.

Thank you.

Mr. Ellis, in reviewing the subcommittee's discussion draft, can you elaborate for us how it would reduce the burden on taxpayers? And can you provide us with specific recommendations to improve it in this regard?

Mr. ELLIS. Sure. Thank you very much, Madam Chairman.

No, we definitely have. I think this bill is a very constructive start in this process. And certainly, the areas where we are going to allow the rates to actually increase, one is that it would go from a 10 percent maximum annual increase to a 20 percent maximum annual increase.

Also, the fact that it increases the deductible for pre-flood insurance rate map properties to $2,000 is something that would help protect taxpayers and reduce some of the subsidy for pre-FIRM properties.

And then, lastly, as you start moving to the special flood hazard properties and essentially the provisions to try to reduce the subsidies by allowing the rates to increase 50 percent in the first year and then 20 percent each year after that—all of those factors really start moving the program in a much more actuarially sound—or much more fiscally sound, and off of the backs of taxpayers.

Chairwoman BIGGERT. Thank you.

And then, for anyone who cares to answer, why has there been a decrease in the number of companies participating in NFIP? Do you think that any primary insurance companies would ever be willing to include flood insurance in the basic homeowner's policy with regard to properties outside the 100-year floodplain?

Ms. JALLICK. I would certainly be willing to take that question.

Chairwoman BIGGERT. Ms. Jallick?

Ms. JALLICK. The main reason carriers have been leaving the National Flood Insurance Program is, number one, the profit margin is very slim.

We receive approximately 30 percent for administering this program. Out of that 30 percent, we pay our agents 20 percent. We then pay State premium taxes of 2 percent, which leaves us 8 percent to manage this program and to pay for all of our costs.

Not only that, the program is very, very technical in nature. And a lot of carriers have felt that, because of the complexity of the program, they do not really have the expertise to remain in the program.

Because of the litigation that has been ensuing over the last few years, they feel like the exposure that they are at due to the litigation is not worth remaining in the program.

Chairwoman BIGGERT. Thank you.

At this time, I yield back the balance of my time.

And Mr. Sherman, you are recognized for 5 minutes.

Mr. SHERMAN. I thank the chairwoman.

I also thank my colleague from Los Angeles for letting me ask questions first.

I think it is in the national interest that we have people insured. You can do this by mandates, or subsidies, or by Federal involvement. Or you can sit back and watch them be uninsured.

The reason that we want to see them insured is apparent to those who are soft-hearted. When the disaster happens, you hate to see people uninsured. No one has ever accused me of being soft-hearted.

But if you are hard-hearted, every time we have a major disaster, we have an extraordinary or supplemental appropriation that comes right out of the Federal budget increases the deficit. And so, it is in the government's interest to make sure people are insured.

That being said, we are here to talk about flood insurance, and I represent a desert. I look forward to seeing how this program can be expanded or used as a model for earthquake insurance. I represent, for example, Northridge.

So, I am anxious to see this program work effectively, even if it costs the Federal Government something to make sure that people have insurance, both in terms of actuarial cost, or in terms of the Federal Government being involved, providing capital at its lower rates, etc.

You may say, that is Federal Government involvement we should not have. But I have been here a while. And every time there is a disaster, all of a sudden, nobody is talking about the deficit. Nobody is talking about the growth of the Federal Government. Everybody is talking about how to help people who are uninsured.

Ms. Jallick, as you know, the Federal Emergency Management Agency has been going through the process of updating the floodplain maps. And there have been questions about the process of developing the maps, and the impact they will have on local communities.

Some homeowners who have never had to buy flood insurance will now have to do so. And homeowners who are currently mandated to buy coverage may not have to in the future, causing confusion in a lot of areas.

What would you do to fix the mapping issues? And do you have any thoughts on why the floodplain remapping has been a problem?

Ms. JALLICK. That is actually a very good question. And I feel your pain. And I feel the pain of all of the property owners who have been moved to a Special Flood Hazard Area.

I think that this is something that is being addressed in the bill. And it does need to be explored, because there are definitely areas that have been removed from the floodplain that should still be in it.

Mrs. McCarthy spoke earlier this morning—she is from Long Island—about structures sitting right on water that were removed from the floodplain, hers being one of them. There are definitely areas for improvement for risk mapping.

I feel that the council that has been put together that is mentioned in this bill is an excellent start. And there are many experts who will be able to properly address this issue and lend us all some insight as to how we can come up with better risk mapping than what we currently have.

Mr. SHERMAN. Thank you.

I now have a question for the record that I would like anyone to respond to after some thought when you go home tonight or tomorrow, or until the record closes. And that is: What should we be doing to make sure that people have the earthquake insurance that they need, both to help them as individuals, to make sure that lenders are willing to loan?

You can tell people not to build in a floodplain. You cannot tell California not to build near an earthquake fault, unless you want to be a 49-State country.

So, what do we do on earthquake coverage? I would like to hear your considered views for the record on that, if any of you think you can provide some enlightenment.

Thank you. And I yield back.

Chairwoman BIGGERT. Thank you.

The gentleman from Georgia, Mr. Westmoreland, is recognized for 5 minutes.

Mr. WESTMORELAND. Thank you, ma'am.

Most of you all are in the business world. How long do you think it would have taken you all to sit down and try to come up with a remedy for losing $18 billion in about 4 years? Would you all have thought about that anywhere down the road?

We are just a little late, I guess, in trying to do this. I think, since 2005, this program has gone in the hole about $18 billion. I think it has paid off a couple of billion since then.

The government does not seem to sense that losing money is a problem. But it is to all the taxpayers of this country, and so, we have to do something to remedy this. But we do not want to do anything that does not make sense.

We have two speeds up here: do-nothing; and knee-jerk. And too many of our solutions come from the knee-jerk type thing.

But Mr. Ellis, I wanted to ask you, is there any type of program that any of the environmental groups or conservation groups have about going in and buying some of this property that may have had a total loss that is adjacent to a wetlands? Or is there any type of program that you all are aware of, or that you all are thinking about trying to create that would do that?

Mr. ELLIS. Speaking for SmarterSafer, the coalition, we are a budget group. But there are environmental groups in that coalition. And certainly, there have been interests both after major disasters to purchase properties and buy out the owners, and then—at the value the home was prior to the disaster—and then using that for conservation or other things along those lines.

There was a separate program that was created years ago called Challenge 21, that was looking at that.

So, I would certainly think that that tool and mitigation are certainly appropriate areas for FEMA and for this program to get involved in, and actually could pay dividends in the long run.

Mr. NUTTER. Mr. Westmoreland?

Mr. WESTMORELAND. Yes.

Mr. NUTTER. Do you mind if I add to that?

The current program, the National Flood Insurance Program, does have funds allocated for mitigating property losses, including purchasing properties that are repetitive loss properties. And then, the Pre-Disaster Mitigation program that FEMA has does allocate money as a percentage of the overall payments for disaster mitigation for just this purpose.

I think our view would be that maybe FEMA has not been as aggressive as it could be in utilizing those funds, and we certainly would encourage the Congress to consider enhancing those funds to achieve the goal that you mentioned.

If I could also answer the comment—it was not really a question—you asked at the beginning about planning?

I represent the reinsurance industry. And nearly all insurance companies and most State insurance plans, like the California Earthquake Authority and others, do, in fact, plan for the outlier year, the severe loss, infrequent year, by buying reinsurance to protect them against that. And that is what we are recommending that the flood insurance program do, as well.

Mr. WESTMORELAND. Okay. Talking about the repetitive losses, I think it is 2 percent of the policies are for the repetitive, but 25 percent of the losses is on the repetitive.

What would some of the insurance companies' idea be for remedying that, when 2 percent of your premiums is covering 25 percent of your losses?

Ms. PARRILLO. Congressman, may I answer that?

I represent a primary insurer. And I would like to remind us of the phrase and the old adage that "once bitten, twice shy." And this is what has happened with repetitive loss properties.

Looking at it as a primary insurer, if we insured flood losses on a property, and some natural disaster came in and the property was destroyed, if the property was rebuilt in the same location with no mitigation, I would be not inclined to insure that property a second time.

And I would suggest that we need corrections in the National Flood Insurance Program to do that. We do not want to allow, to have people rebuild in areas that, under the same circumstances, will have these repetitive losses. It is simply not fair to the American taxpayer.

There are folks who wish to do so. If they wish to rebuild in these areas, they need to be charged actuarially sound rates. If they want to absorb that risk, they need to pay for that risk.

They need to pay for it, not the American taxpayer.

Mr. WESTMORELAND. Yes. I could not agree with you more.

Mr. Rutenberg, I come from a homebuilding background, too. And a lot of times, you are faced with having a lot that has a lot of contour to it, let us say. And part of it is in a floodplain, a 100-year floodplain, or whatever, but the floor level may be 15 feet above the flood level.

My experience has been that the homeowner still had to buy flood insurance, even if the floor level was at a level that it would be impossible to flood. Has that hindered you? Or have you found that in any of the subdivisions, or whatever, that you have done business in?

Mr. RUTENBERG. Yes, Congressman. We do find that it is an issue for some people. But other people are willing to say, if I want to be on this lot—or normally, there is a nice view, or something else, that they will pay the premium. And we have to work with our county to build it in a way that will ensure that it is not a burden in the future.

I think I might, if I could quickly add that, in many of the new developments that we are doing, in my area we now build for an 18-inch rain storm event. We have other developments that have no retention areas whatsoever, or somewhere in the middle, and we are all paying the same.

And perhaps in the future we should be looking at whether or not we should be charged based upon the risk. And if you have that much capacity for stormwater, then maybe that is a lower risk.

I would also suggest that, if you are looking for things to do, that we seem to have a few people available to work on mitigation. And for that 1 to 2 percent, there may be a program we want to do, a lower interest rate program, or something on that order, for people to go ahead and modify their homes out of their own money, spend their money. And that would reduce the risk to the program.

Mr. WESTMORELAND. Yes, sir.

Mr. RUTENBERG. Thank you.

Chairwoman BIGGERT. The gentleman's time has expired.

Mr. WESTMORELAND. And I yield back.

Chairwoman BIGGERT. Thank you.

I would note for the record that one town in Illinois, due to repetitive loss, moved the town to higher ground. So, I think there are various ways that we can take care of that.

I would now recognize Ms. Waters of California for 5 minutes.

Ms. WATERS. Thank you very much, Madam Chairwoman.

I am sorry that our FEMA representative had to leave, but certainly had to leave for a good reason. I had a number of questions that I would have liked to have asked.

Chairwoman BIGGERT. Maybe we will try and get him back at a later date.

Ms. WATERS. Okay.

Let me talk about my bill, H.R. 1026. It would restore stability to the Flood Insurance Program by reauthorizing the program for 5 years. It would also address the impact of new flood maps by delaying the mandatory purchase requirement for 5 years, then phasing in the actuarial rates for another 5 years and make further improvements to the program.

That is a little bit different from your bill, Madam Chairwoman. But I think we are both committed to working to see how we can find the best solutions.

I would just like to ask the panel—I do not want you to take sides, but I want to find out—what about the time, 2 years as opposed to 5 years? What do you think makes good sense and is reasonable, and would help us to get everybody into the program at the correct rates, and basically help us to stabilize this program?

Can I get a response from anyone? Give me your thoughts.

Mr. ELLIS. Congresswoman Waters, we would be concerned to have a longer delay, such as is envisioned 5 years, and then slowing in the rate increase, just because the people are in the floodplain. We are essentially denying them some of the information that they are actually in the floodplain. And we want to give them the tools, and some of that is the rates and understanding of that.

And so, basically freezing the maps or denying them to go into place does not really help the communities.

I would much rather pursue an approach, such as in the draft legislation, that would phase in the rate increase, so it is not a shock to the system. And then, if there are people who are unable to pay, who are truly needy, then we should have, outside the rates, certain subsidies to enable them to purchase flood insurance.

I think that is a better way to go, Congresswoman, and something that would be responsible to the taxpayer and to the—

Ms. WATERS. Based, then, over what period of time?

Mr. ELLIS. I am amenable to the timeline that is in the draft legislation. It could be a year that they would—say that you do not have to do the purchase, and then they extend it for a year, and a year after that, up to 3 years.

I would rather see briefer and no delays, and just try to deal with the rates. But I am amenable to that sort of balanced approach.

Ms. WATERS. Anyone else?

What about the question of the cost to the taxpayers with subsidies?

Mr. ELLIS. The subsidies are there right now. We have a program that is $18 billion in the hole. I certainly think that we are going to have to deal with this issue to try to have affordability for insurance for people who are truly needy, and something that is outside the program.

I am not sure what the costs would necessarily be, but I think it is important that we get people the accurate maps. And we have these tools, which some of it is knowing that they are in the floodplain, or what type of floodplain they are in.

And the second thing is knowing what it costs and what the true cost of living in harm's way is. And that gives them some decision-making to deal with about where their home is, or mitigation measures they could take that would reduce the cost or reduce their vulnerability.

Ms. WATERS. Let me, Madam Chairwoman, just say, in addition to my concern about the time for phasing in people with the correct actuarial rates, I am concerned about too many communities in this country that are improperly, incorrectly mapped, and the ability of individuals and communities to oppose the mapping and how we are going to resolve that.

And what impact does that have on the delays that I am speaking about?

I want the mapping to be as accurate as it possibly can, to avoid people being in the situation where the mapping is incorrect, the flood zones that are created or identified through the mapping, or are not proper.

I just went through one of these in my district where, luckily, the community got together and just worked very, very hard, and got it changed. But I do not know how much of that is out there, and whether or not if we need to also think about that as we do a delay of getting the program on track.

Chairwoman BIGGERT. If the gentlelady would yield?

Ms. WATERS. Yes, I yield to the Chair.

Chairwoman BIGGERT. I think that, actually, Congresswoman McCarthy was here and had very much sort of the same concerns and some maps that she believed were really mistaken. It sounded like that. So, this is an issue. And I think the first panel replied that there is an appeals process that people should take advantage of.

But you are right. We need to make sure that is correct. And I think that we have in this draft attempted to address that issue, and that mandatory purchase requirement would be suspended for 1 year with the possibility of 2 additional 1-year suspensions provided that FEMA makes a finding with respect to the flood risk mapping on a community-by-community basis.

Ms. WATERS. You are talking about when they are in the appeals process?

Chairwoman BIGGERT. No, I am talking about what is in—now I am talking about what is in the draft legislation that we have been talking about.

Ms. WATERS. That deals with the incorrect mapping issue?

Chairwoman BIGGERT. That is correct. Yes. So, I think that there is something in there that you will like—

Ms. WATERS. Yes, I would like to talk further with you about it, if I may, because I am told that if you get a study, that costs money, that individual homeowners can do studies, and the communities can do studies. But it costs money to do that.

And I am not so sure—

Chairwoman BIGGERT. If I might again?

Ms. WATERS. Yes.

Chairwoman BIGGERT. We also have a mapping council in the bill, so that this can be done, other than having the communities having to do their own study.

But I do not want to take any more time—

Ms. WATERS. Okay. Thank you.

Chairwoman BIGGERT. The gentleman from Virginia, our vice chair, is recognized for 5 minutes.

Mr. HURT. Thank you, Madam Chairwoman.

Welcome. Thank you all again for being here and for helping us sort through this important matter.

As I said during the first panel, it seems to me our primary responsibility, or a primary responsibility as we look at this, is, obviously, trying to figure out how we minimize the impact to the taxpayer and be good stewards of our responsibility that way.

And then, I think also it is incumbent upon us in Washington to not promote policies that create moral hazard. And obviously, I know that is of great interest to you.

I have a question, maybe for Mr. Ellis, and then maybe Mr. Houldin and Ms. Parrillo. And Ms. Jallick, I would like to hear the perspective from your quarter.

But my question is: What is our goal here, and what is achievable?

Are we able to minimize the impact, if this bill goes forward? Do you think that this will be effective in minimizing the impact of subsidies to the taxpayer?

We have heard different figures, $1.3 billion of taxpayer built-in subsidy, $1.8 billion. And that is obviously on top of the $18 billion debt that has accrued.

And then, secondly, I think, addressing the issue of moral hazard, will we be encouraging or discouraging to the maximum extent possible homeowners from making decisions that not only threaten their property—and that is, obviously, your concern as members of the insurance industry who are here, is the property issue.

But obviously, as we see in Japan, it is not just property. It is also lives. And so, I was wondering if you could address kind of the big picture or where we are going with this.

Mr. ELLIS. Sure.

Mr. HURT. And how do we measure our success?

Mr. ELLIS. That is always critical, I think, with any government program, is trying to figure out how to measure success, Congressman Hurt. And I think that what we are trying to do, or what we would like to see at Taxpayers for Common Sense, and then also at SmarterSafer.org, is to move this program into a sounder fiscal footing.

So, to move it to where first, people actually know the risk. And part of it is having accurate and up-to-date flood maps, so that they actually know where they are living, or buying a home.

Second, that they understand the cost of that risk, that they are actually purchasing insurance that is commensurate to the risk that is actuarially sound, so that they have also that tool, sort of an understanding of where they live. And then also, how to mitigate or reduce that risk.

And lastly, and very important for our group, is trying to remove that risk off the back of the taxpayer and putting it back on to the policyholders where it logically belongs.

And so, I think that, we created this program in 1968, and we are stuck with it. And there is not a private market—a large private market anyway—in flood insurance.

We are going to have to deal with this program and try to move it towards a more actuarially sound basis and also try to use it as a tool to help people out—not just help them out in buying flood insurance, but help them out of harm's way—to give them those tools and that information to reduce their risk and also reduce the impact on the American taxpayer.

Mr. HOULDIN. Congressman, I agree with the actuarially sound concept. I will not go into that further.

But as somebody who sells the policy to the consumer on a daily basis, I think we actually need to make the program more attractive, because the more people that we get to buy the product, the larger the number is, the bigger the risk pool.

And so, one of the components of the draft legislation that I feel—as somebody who sells to the consumer every day—is very important is the loss-of-use coverage for the residential property, where we could actually have some coverage for them to live elsewhere if there is a flood loss, and the business interruption on the commercial side.

Because right now, when you are trying to sell this product to the consumer, there is a lot in the bill—or a lot in the policy—that a lot of coverage that is not there, that I think would make it more attractive.

Those components, although we are expanding the policy to some degree, we can make actuarially sound right off the bat. And I think that the consumer will find it a much more attractive program.

Ms. JALLICK. I am sorry. Go ahead.

Ms. PARRILLO. Thank you, Congressman. There are two things I would like to address.

First, as a representative of the National Association of Mutual Insurance Companies, we believe that the program is necessary. There is not a private market that is available at this time to be able to insure those properties. But it does need to be reformed. It does have significant weaknesses.

The first thing I would like to talk about is the take-up rates. In my testimony, I testified that less than 30 percent of people who are in those floodplains actually purchase the insurance.

First of all, they may not purchase it. If they do, purchasing a new home, they have a federally-backed mortgage, they are required to have flood insurance. They do, and it lapses. There need to be penalties there to ensure that does not happen.

As my colleague here talked about the law of large numbers, that is what the insurance mechanism is, how it is predicated on that basis. We need to have enough people in there who will pay a little, so we will be able to spread the risk across a larger base. It will keep the prices reasonable and affordable.

The second thing I would like to talk about is the idea of the actuarially sound rates. And I will take that up. I think that is an absolute necessity to this program.

And there are two points I would like to make about the actuarially sound rates. First of all, the NFIP was formed on the basis, in 1968, of gradually moving toward actuarially sound rates for all properties in the program. Here we are 40 years later, and we are not close to that.

We need to be able to be disciplined in the program to be able to get to that point, be it 2 years or 5 years.

Secondly, these subsidized rates, as they are in effect right now, apply to all properties, to all property owners, regardless of their ability to pay. If you own a beautiful property, a waterfront, and you are well established, and you can well afford to pay for the cost to insure that property for flood insurance, you are paying the same rate as that individual who is in a property, perhaps of lesser means.

Maybe they have been there 40 years and they are on a pension. They are paying the same rate. We feel that is fundamentally unfair.

So, that is why we are proposing, to move toward actuarially sound rates should be supported by some type of means-based testing for those folks—now, again, not through the Flood Insurance Program. If you bury that quote, that subsidy in the Flood Insurance Program, the insurance mechanism, it is hidden to all. It needs to be transparent.

So, it needs to come outside of the Flood Insurance Program and deal with those individuals who truly need the assistance of government. And the others who do not, who can pay for it themselves and choose to live in those properties, they should absorb the costs themselves.

Ms. JALLICK. I would like to comment first on the fact that I do not feel that we are stuck with the National Flood Insurance Program. I think we should all be extremely fortunate that we do have the National Flood Insurance Program.

The National Flood Insurance Program has worked in the manner that is was designed to work. It was designed to protect people for a general condition of flooding. The rates were designed based on an average loss year.

Therefore, when you look at a catastrophe like Katrina, the bill was never designed to fully make the program actuarially sound with something like a Katrina.

The NFIP did not fail during Katrina. The levees broke. The system is not broke.

The most important goal here is for this program to continue to protect the 5.6 million people who currently have a flood policy in place. This bill goes a long way towards reducing the Federal subsidies and the moral hazard, and addressing lingering concerns, such as mapping, which is a true concern.

Mr. NUTTER. Mr. Hurt, do you mind if I add one more comment to that about the actuarial rates?

Chairwoman BIGGERT. One minute.

Mr. NUTTER. The program does not include a factor for catastrophe loss years like 2005, but it should. The reason you have all this Federal debt is because it does not plan for and it does not price for all of that.

So, if you want to send the right signal to the policyholders who live there, but if you also want to protect taxpayers, you really do need to factor in that rate. Or as I have suggested on several occasions, the program needs to be purchasing reinsurance as a way to protect against the outlier year.

Thank you for the opportunity.

Chairwoman BIGGERT. Thank you.

The gentleman from Missouri is recognized for 5 minutes.

Mr. CLEAVER. I just have one question, Madam Chairwoman.

I disagree with your statement, Ms. Jallick. I think there were some things broken other than the levees in the Gulf.

Shortly after Katrina, the Chair, Ms. Waters and I, along with, I think, three other Members, went to the Gulf. We held hearings in New Orleans and in Biloxi.

Katrina was not partisan. We lost a Republican Senator's home, and the home of a Democratic Member of the House.

And the thing that I think has to eventually be addressed is this whole issue of wind. Gene Taylor, Congressman Gene Taylor, only had his steps remaining on the lot where he lived.

And I guess the question is: How do you determine whether the house was washed away by the flood, or whether the house was blown away by the wind?

And it seems to me that what was broken was that it provided a lot of insurance companies with a way out. They just declared, you do not have wind insurance, and your house is not here because of the flood.

It seems to me that is something that has to be repaired, as secondarily to the repair of the levees.

Ms. JALLICK. In 99 percent of the cases, the two adjusters who are assigned to assess the damage will be able to determine the difference between wind and water. It is very rare when the professional adjusters in the field cannot make that determination.

Adding wind to a policy would just add more debt to the taxpayers. Whereas this particular bill, I feel very strongly that it, while not a perfect bill, is a bill that can get enacted into law—

Mr. CLEAVER. Okay. I support the bill. I want to deal with what I was trying to deal with, which is, we have a problem.

If you are saying that there can be concrete evidence and proof on whether it was flood waters or wind, why were we having so many controversies if was so easily determined?

Ms. JALLICK. Again, I do believe, 99 percent of the time, you do have the ability to distinguish between the wind and the water.

And on a very rare occasion—and again, Katrina is something that was not foreseen, not expected. And hopefully, we can take some of the missteps that we feel happened during Katrina and learn from them, and put things into law going forward that will help to shore up any type up misconceptions between the wind and the water.

Mr. CLEAVER. Thank you.

Ms. JALLICK. And the expert council that is designed in this bill should be able to assist with that, as well.

Chairwoman BIGGERT. The gentleman yields back?

Mr. Stivers from Ohio is recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman.

And I would like to thank the witnesses for being here and sharing your expertise.

It seems to me that we all know that the Flood Insurance Program has to do a better job of pricing risk, number one. The flood insurance program also has to—we have to decide how much risk we want to give the taxpayers, number two, and whether we want to have the taxpayers have a lot of risk.

The third issue, I think, is how we deal with broader participation. We need to all recognize that there are people who live in areas that probably should be participating in the Flood Insurance Program who are not participating.

And then the fourth issue to me personally is, I think we need to figure out how we can encourage growth of the private market over time, not necessarily immediately, and I do not think it will happen immediately.

I would like to kind of hit those one by one.

And I know that some of your written testimony talks about pricing risk. I have a real concern about the government's ability to price risk. It just has shown, not just in the Flood Insurance Program, but in many programs in many ways, that the government does not do a very good job of pricing risk.

Do you have any specific recommendations—any of you—that would help the government do a better job of pricing risk?

Mr. NUTTER. Mr. Stivers, Frank Nutter. We represent the reinsurance market.

And the point that I have made about two suggestions we have made is that, if you introduce the private reinsurance market into the program, you have introduced into it the risk assessment mechanism that the private reinsurance market does, which it does routinely for catastrophe risk, for earthquakes and tsunamis, and floods and windstorm.

And I have made two proposals. The first is that the program actually go into the market and seek to lay off risk into the reinsurance market on the basis of a data analysis between the NFIP and appropriate brokers.

And second, there is a pooling mechanism in the existing legislation that has been dormant for 40 years—35 years. And while I am not suggesting it be reinstituted, I am suggesting that it does provide an opportunity for the private sector on a reinsurance basis to participate through a pool with the program. And again, it would have that interaction with the private sector risk pricing, risk assessment mechanism.

Mr. STIVERS. Thank you.

And briefly—that was a pretty good answer—does anybody else have any other ideas, suggestions? Yes?

Mr. ELLIS. Yes, Congressman. I would just like to add that part of it—you are right. Government is never going to be that good at pricing risk, just simply because it is not good politics, necessarily. Charging people would actually cost—

Mr. STIVERS. Terrible politics—

Mr. ELLIS. So, part of the way to guard against that is to make sure that we do not expand the program, so we do not add in wind insurance, or we do not actually add in, as has been suggested and is in the draft, coverage for business interruption or other areas that could be insured separately, just because we know that government is inherently flawed in that.

And so, the more that we expand the program, or even increase annually the levels that are available in insurance, we are crowding out the private market, and we are putting the government potentially more on the hook at not pricing risk adequately.

So, some of it is just, do not make it worse.

Mr. STIVERS. Thank you for that.

Let us talk a little bit about encouraging participation—and I cannot read your name, I apologize. I know you talked about the lack of participation.

Are there proposals that would—you could pass a law that says everybody has to get it. We passed a law in the 1930s that said nobody could drink—or the 1920s—and people drank. So, passing a law will not necessarily mean compliance.

What I am curious about is how do we get more compliance of people who should be buying flood insurance to buy flood insurance, as opposed to just saying it is mandatory? Which, obviously, it is maybe a start, or part of it. But I do not think that alone is the solution.

Ms. PARRILLO. I think the bill does a very fine job in going down the road of ensuring compliance with it. There are mandatory purchase requirements regarding properties that are backed by federally-backed mortgages. And there needs to be a continued enforcement on it.

Within the National Flood Insurance Program, they need to be able to track better those properties that have flood insurance, and in the event they allow those policies to lapse, to be able to institute any type of remedial action or penalties to ensure that it is done.

Mr. STIVERS. Thank you. Let me ask you, let us say my house is paid off. I do not have a mortgage. How do we enforce that?

Ms. PARRILLO. I do not think you can enforce that. But I would suggest that a prudent person would want to protect their largest financial asset. And that may not be a position for the National Flood Insurance Program, but one of understanding the risks that we all have.

And I know my colleagues, as independent agents, will counsel our clients that the exposures that they have, and to properly protect those exposures.

Mr. STIVERS. Let me let somebody else weigh in, because I only have a limited number of time. Thank you.

Mr. HOULDIN. I just wanted to mention that anything that a consumer wants to purchase, they are going to purchase, if it is an attractive product to purchase. And right now, the program has a lot of unattractiveness to it. I hear it every day.

When I explain the program to a client, it is like, no, I do not think it is something I need.

I think this bill does a lot towards making the policy and the coverages much more effective.

Mr. STIVERS. Thank you, Madam Chairwoman. I am sorry. I am out of time.

Chairwoman BIGGERT. Thank you.

Without objection, Mr. Cleaver is recognized.

Mr. CLEAVER. Thank you for your generosity, Madam Chairwoman. This will be very short.

I gave up caffeine for Lent, and so I have a headache.

[laughter]

And I have to get on an airplane. And I have a double headache, because I am on this wind versus the flood.

Can somebody explain to me what you did to determine whether a house was blown away or washed away?

Because, as I am sure you know, there were throngs coming to us about that issue. And as I said, we saw steps remaining, the only thing remaining—can you measure something on the cement? Help me, somebody.

Ms. JALLICK. If the structure is no longer there, then the wind and water adjusters are going to work very closely together and look at the proximity to water lines, perhaps. Was there a surge that had occurred, which then definitely would be the cause of loss was water? If there was a tornado, or through wind-driven rain that it was determined that the house was destroyed by wind?

But they would pull weather reports. They would do a lot of investigation to make that determination, call in engineers if need be.

Quite frankly, there are going to be times when maybe they cannot make that determination. And at that point, then, we would expect that the wind and the water carrier would then split the cost of the damage.

And it is very unfortunate when that happens, but it is also extremely rare when it happens.

Mr. CLEAVER. Not in Katrina.

Ms. JALLICK. Very rare.

Mr. CLEAVER. Not in Katrina.

Ms. JALLICK. But again, Katrina was not a normal event, as well.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Mr. RUTENBERG. May I answer that?

Chairwoman BIGGERT. Who was speaking? Go ahead.

Mr. RUTENBERG. You can quite often tell by the construction and by the date of the construction, because as we have been evolving the construction techniques and the building codes, the newer homes are much more protected against wind than the latter ones. And depending upon the area and the code that it was built on, there are often very good clues. Then, again, that goes to the insurance professionals.

You should know from the viability of the NFIP that the newer houses are being built to much higher standards. And therefore, the risks are diminished.

Chairwoman BIGGERT. Thank you.

I would like to ask you, any of you who could offer suggestions, how would Congress structure assistance for certain homeowners, whether we want to do, say, means-testing or modest-income homeowners outside of NFIP?

So, if you have a suggestion, if you could submit that for the record, I would appreciate it.

And as I mentioned earlier, during the coming months, our subcommittee intends to mark up legislation and implement several reforms that will improve the financial integrity and stability of the program. And I think legislation will require an examination of ways to decrease the role of taxpayers and increase the role of private markets in flood insurance.

So, more specifically among several provisions, our reform measure will aim to improve flood maps to a fair and transparent process, phase in adequate rates for risk, increase program flexibility to better serve homeowners, and enhance local communities' ability to enforce building codes.

So, NFIP reforms must enhance the program and protect both taxpayer and policyholders.

And with that, I would really like to thank all of the witnesses. I think you really have highlighted a lot of issues and explained it to a lot of our members who have not been through flood insurance before. So, this has been very helpful. I really appreciate it.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And with that, this hearing is adjourned.

[Whereupon, at 1:26 p.m., the hearing was adjourned.]

A P P E N D I X

March 11, 2011

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on Insurance, Housing, and Community Opportunity, Committee on Financial Services, House of Representatives

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FLOOD INSURANCE

Public Policy Goals Provide a Framework for Reform

Statement of Orice Williams Brown, Managing Director
Financial Markets and Community Investment

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Highlights

Highlights of GAO-11-429T, a testimony before the Subcommittee on Insurance, Housing, and Community Opportunity, Committee on Financial Services, House of Representatives

March 11, 2011

FLOOD INSURANCE

Public Policy Goals Provide a Framework for Reform

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 March 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 and on its ongoing review of FEMA's management of NFIP, which focuses on its planning, policies, processes, and systems. The management review includes areas such as strategic and human capital planning, acquisition management, and intra-agency collaboration.

GAO has made numerous recommendations aimed at improving financial controls and oversight of private insurers and contractors, among others.

View GAO-11-429T or key components. For more information, contact Orice Williams Brown at (202) 512-8678 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, currently 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 needed it, limiting postdisaster assistance for flooding, and phasing in premium rates that fully reflected 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 were 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 were 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 previous reports GAO has identified weaknesses in areas that include financial controls and oversight of private insurers and contractors, and has made many recommendations to address them. While FEMA has made progress in addressing some areas, preliminary findings from GAO's ongoing work indicate that these issues persist and need to be addressed as Congress works to more broadly reform NFIP.

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee:

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 March 2011, NFIP still owed approximately $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 past reports and are examining in ongoing work. 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.

Background

The National Flood Insurance Act of 1968 established NFIP as an alternative to providing direct assistance after floods.[1] NFIP, which

[1]Pub. L. No. 90-448, Title XIII, 82 Stat. 476 (1968).

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.[2] 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.[3] 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.[4]

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 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 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

[2] Pub. L. No. 93-234, §102, 87 Stat. 975, 978 (1973).

[3] Pub. L. No. 103-325, 108 Stat. 2255 (1994).

[4] Pub. L. No. 108-264, §§ 102, 104, 118 Stat. 712, 714, 722 (2004).

premium rates have continued to grow.[5] In response to the magnitude and severity of the losses from the 2005 hurricanes, Congress increased NFIP's borrowing authority from the Treasury to $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.[6]

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.

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. 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 that they made the

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

[6] 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).

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 (PRP) Eligibility Extension that in effect equals a temporary grandfathering of premium rates.[7] 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 catastrophic losses, as occurred in 2005, and may need to borrow from Treasury to pay claims in those years.[8]

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 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 would be required to cover the full risk of

[7] The PRP 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.

[8] 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.

loss. 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).[9] 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. 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.[10] This assistance could take several forms, including direct assistance through NFIP, tax credits, or grants. In addition, to the extent that those who might forego coverage were actually required to purchase it, additional actions could be taken to better ensure that they purchased policies. According to 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.[11]

[9]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.

[10]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).

[11]RAND, *The National Flood Insurance Program's Market Penetration Rate: Estimates and Policy Implications* (Santa Monica, Calif.: 2006).

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.[12] 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 that it may never be repaid, could in fact increase, 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.[13] 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 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

[12]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.

[13]See GAO-09-20.

Severe Repetitive Loss Pilot Grant Program.[14] 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.

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.[15] Having multiple programs may not be the most cost-efficient and effective

[14]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 4 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 2 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).

[15]These programs include the Flood Mitigation Assistance Program (FMA), the Repetitive Flood Claims Program (RFC), and the Severe Repetitive Loss Program (SRL). Moreover, the Hazard Mitigation Grant Program (HMGP) and the Pre-Disaster Mitigation Program (PDM) are two additional hazard mitigation programs that are not specific to flooding.

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.[16] 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 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

[16] RAND, *The National Flood Insurance Program's Market Penetration Rate.*

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.[17] The 2006 RAND study estimated that 180,000 to 260,000 insurance policies for both primary and gap coverage were in effect.[18] 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.[19] 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 or all 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.[20] For example, it would

[17]See GAO-09-420R.

[18]RAND, *The National Flood Insurance Program's Market Penetration Rate.*

[19]See GAO-09-420R.

[20]See GAO-08-7.

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 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 ongoing work examining FEMA's management of NFIP—covering areas including strategic planning, human capital planning, intra-agency collaboration, records management, acquisition management, and information technology—some similar issues are emerging. For example, preliminary results of our ongoing work show that FEMA:

- does not have a strategic plan specific to NFIP with goals, objectives, and performance measures for guiding and measuring the program;

- lacks a strategic human capital plan that addresses the critical competencies required for its workforce;
- does not have effective collaborative practices that would improve the functioning of program and support offices;
- lacks a centralized electronic document management system that would allow its various offices to easily access and store documents;
- has only recently implemented or is still developing efforts to improve some acquisition management functions, making it difficult to assess the effects of these actions; and
- does not have an effective system to manage flood insurance policy and claims data, despite having invested roughly 7 years and $40 million on a new system whose development has been halted.

While FEMA has begun to acknowledge and address some of these management challenges, additional work remains to be done to address these issues. Our final report will include recommendations to address them.

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 did 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 refused 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 Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, this concludes my prepared statement. I would be pleased to respond to any of the questions you or other members of the Subcommittee 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 Tania Calhoun, Emily Chalmers, Nima Patel Edwards, and Christopher Forys.

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TAXPAYERS FOR COMMON SENSE
MAKING GOVERNMENT WORK

Testimony of Steve Ellis
Vice President, Taxpayers for Common Sense

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
hearing on
"Legislative Proposals to Reform the National Flood Insurance Program"

March 11, 2011

Good morning, Chairman Biggert, Ranking Member Gutierrez, members of the subcommittee. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog. Thank you for inviting me here today to testify on reform of the National Flood Insurance Program (NFIP).

Taxpayers for Common Sense has advocated for reform of the National Flood Insurance Program since our inception sixteen years ago. This time is easily divided into two sections. The first ten years our concerns about the program's subsidies and underlying risk to taxpayers were met with skepticism from many quarters. But after the devastating hurricane season of 2005 and with the nearly $18 billion the program is in debt to the Treasury, all have recognized NFIP is fundamentally flawed and must be reformed. The question is how.

Any reauthorization of the National Flood Insurance Program must make significant changes to put it on sounder financial footing, and help it climb out of its budgetary hole with more actuarially sound rates and accurate maps. The discussion draft of reform legislation being circulated by the committee is a good start. It responsibly tackles rate and subsidy issues, creates a mechanism to increase confidence and accuracy in flood mapping, and doesn't stick taxpayers with the tab of bailing out a failed program. However, we are concerned with provisions that could inhibit adoption of updated maps, add a new business line to the program, and mandate annual coverage limit increases that will ensure the program's liabilities actually increase each year. We look forward to making this good start an even better final product and applaud the committee for taking this up early in the session, increasing the likelihood that a reform measure will pass this Congress.

TCS is allied with SmarterSafer.org, a coalition in favor of environmentally responsible, fiscally sound approaches to natural catastrophe policy that promote public safety. The groups involved represent a broad set of interests, from free market and taxpayer groups to environmental and insurance industry groups.[1] The depth and breadth of the coalition underscores the importance of reforming NFIP. I would like to submit for the record SmarterSafer.org's principles for reform of the National Flood Insurance Program.

As they say, those who ignore history are doomed to repeat it. When looking at the reforms, it is important to look at the mistakes that saddled taxpayers with a flood insurance program that is $18 billion in debt[2] and only has annual revenues of $3.1 billion.[3] Even if you exclude ridiculously low interest payments and administrative costs, it would take more than six straight years with no claims to pay the debt back. Obviously, this isn't going to happen.

This is also about fundamental fairness within the flood insurance program and eliminating the cross subsidies that have a few properties paying full freight while picking up the tab for properties that have enjoyed subsidized premiums for decades.

Unintended Consequences

After years of ad hoc disaster aid being meted out by Congress, the National Flood Insurance Program was established in 1968 to create "a reasonable method of sharing the risk of flood losses through a program of flood insurance which can complement and encourage preventative and protective measures."[4] The program was to make up for a lack of available flood insurance. But even at that time Congress was warned that it was playing with fire. The Presidential Task Force on Federal Flood Control Policy wrote in 1966:

> A flood insurance program is a tool that should be used expertly or not at all. Correctly applied it could promote wise use of flood plains. Incorrectly applied, it could exacerbate the whole problem of flood losses. For the Federal Government to subsidize low premium disaster insurance or provide insurance in which premiums are not proportionate to risk would be to invite economic waste of great magnitude.[5]

Well, we know which way that story unfolded. Although subsidies were largely envisioned to be limited and short-term, they weren't. And while the program has encouraged standards and construction that help reduce flood risks for participating communities, the availability of cheap federal flood insurance over the last several decades made it financially attractive to develop in

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1 Full list is available at www.smartersafer.org

2 Statement of Orice Williams Brown, Director Financial Markets and Community Investment, Government Accountability Office before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives. April 21, 2010. P 1. Available at http://financialservices.house.gov/media/file/hearings/111/brown_4.21.10.pdf

3 Congressional Budget Office. "The National Flood Insurance Program: Factors Affecting Actuarial Soundness." November 2009. P 1. Available at http://www.cbo.gov/ftpdocs/106xx/doc10620/11-04-FloodInsurance.pdf

4 P.L. 90-448.

5 U.S. Task Force on Federal Flood Control Policy. "A Unified National Program for Managing Flood Losses." August 1966. P 17. http://www.loc.gov/law/find/hearings/floods/floods89-465.pdf

high risk areas. Along with other factors, NFIP helped fuel the coastal development boom that increased the program's risk exposure and losses.

To foster increased participation, the NFIP does not charge truly actuarially sound 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.[6] 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.

NFIP's fiscal solvency is further challenged because properties that pre-date a community's involvement in the NFIP or the applicable flood insurance rate map (whichever is later) enjoy significantly subsidized rates, paying only 35-40% of their actual full-risk level premium.[7] 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, an analysis by *USA Today* found 1.2 million buildings receive these discounts.[8] FEMA puts the percentage of properties in the NFIP receiving explicitly subsidized rates as more than 20%.[9]

Furthermore, properties experiencing repetitive losses make up a disproportionate amount of the program costs. A repetitive loss property is one that has had two or more claims of $1,000 over ten years. These properties represent only one percent of the total number of policies, yet account for up to 30% of the cost of claims.[10] Properties like one in Wilkinson, MS that has flooded 34 times since 1978 and received payments worth nearly ten times the home's $70,000 value. Or another property owner in Houston, TX that has received $1.6 million worth of claims for a house worth $116,000.[11] We need to help these people out – out of harm's way – and at the same time help the taxpayer who is picking up the tab.

Committee Draft on Rates

The draft legislation provides a mechanism to move toward actuarial rates for many properties.[12] Also the increase of the deductible for pre-FIRM properties to $2,000 is appropriate.[13]

First the graduated phase in of rates for newly mapped areas is responsible for both the homeowner and the program. The draft legislation provides that for the first year the rate would be 50 percent of the total and then increase 20 percent annually after that until the full

[6] Hayes, Thomas L. and Neal, D. Andrew. "Actuarial Rate Review," Federal Emergency Management Agency. October 1, 2010. P.5.
[7] Congressional Budget Office. Supra Note 3 at 6.
[8] Frank, Thomas. "Huge Losses Put Federal Flood Insurance Program in the Red," USA Today. August 26. 2010. Available at http://www.usatoday.com/news/nation/2010-08-25-flood-insurance_N.htm
[9] Hayes and Neal. Supra Note 6 at 22.
[10] Brown. Supra Note 2 at 8.
[11] Frank. Supra Note 8.
[12] Sec. 5
[13] Sec. 4(b)(1)

rate is in effect. In addition, the legislation stipulates that commercial properties, second homes, newly purchased homes, substantially damaged or improved homes, and severe repetitive loss properties have their rates increased by 20 percent annually until they are paying the estimated risk premium rate. In addition the draft legislation directs that subsidies not be available to lapsed policies.

By and large all of these changes make sense and move the program in the right direction. Presumably, post-FIRM properties will pay appropriate risk-based rates as maps are revised and improved through the bills mapping improvement efforts. What appears to remain unchanged are pre-FIRM properties that do not meet any of the specific criteria remain subsidized. It is not clear how many properties or the potential losses this represents, but it is an area that must be reformed. These properties have been subsidized for decades.

Accurate Maps Are Critical

The NFIP is driven by maps. They determine the veritable alphabet soup of what flood zone your structure is in: A, V, X or variants within each category. Your property could be in the 100-year floodplain or the 500-year floodplain; high-risk storm surge zone or special flood hazard areas. Your property could pre-date the flood insurance rate map (FIRM) or otherwise be eligible for significantly subsidized premiums. 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 FEMA's map modernization program is so critical to the long term fiscal viability of the program.

The nation's floodplains are dynamic. Not just from natural forces, but also the impacts of development, weather patterns, and topographical changes. Areas that were previously less likely to flood could now be more likely. Levees that were adequate to provide 100-year protection a decade ago may provide far less due to poor maintenance or increased flood elevations due to increased runoff or new development.

Since 2003, FEMA has been working to update thousands of flood maps. In addition, levees are being reviewed and in some cases decertified for not meeting the required level of protection. According to FEMA, the nation's special flood hazard areas (SFHA) have grown in size by seven percent. While this revealed more land and housing is vulnerable to flooding, other areas are less vulnerable. In fact, the number of housing units in SFHAs has seen a net decrease of one percent.[14]

Not surprisingly, the map modernization effort has been met with some controversy. In some cases, homeowners are facing steep increases in premiums after many years of paying the same rate. While the uproar is understandable, it doesn't change the underlying circumstances

[14] 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

or the risk. In some cases property owners that didn't have to purchase flood insurance under existing law now find themselves required to do so. But just because it isn't popular doesn't mean it's not the right thing to do. What isn't the right thing to do is ignoring the realities on the ground – literally – and not requiring flood insurance in these instances. Because it means when the inevitable floodwaters appear, the homeowner will not be covered by their regular insurance and the taxpayer will be asked to open up their wallet to bail them out. In fact in many cases it makes sense for the homeowner to purchase flood insurance even if they are not required to do so.

It may be politically expedient and popular to delay map modernization or waive building standards. But what may make good politics generally makes bad 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 taxpayers deserve to have those who choose to live in harm's way pick up their share of the tab.

Committee Draft on Mapping

The draft legislation establishes a flood mapping advisory council[15] to develop new standards for flood insurance rate maps that would incorporate true risk, be graduated and reflect realities on the ground – both man-made and natural. The broad membership and public outreach required are critical for a successful effort that has the buy-in of all affected constituencies. In addition, the direction that FEMA implement the new protocols[16] is critical. The requirement that rate maps be graduated to at least include not only the 100-year floodplain, but also the 250-year, residual risk areas, and possibly be graduated further, is a major step in the right direction for both the fiscal health of the program and informing the public of the actual flood risk to their property.

Just to be clear, the council and the development of new mapping standards should not and will not delay map modernization – that critical next step should continue. This will just provide for better, even more detailed maps in the future.

We appreciate that unlike the bill passed by the House last year, the draft legislation does not automatically delay the implementation of new maps and excessively slow walk rate increases. However, provisions in the draft legislation could potentially delay or undercut the effects of the new maps. The draft gives the Administrator authority to suspend flood insurance purchase requirements for areas that new maps place in special flood hazard areas. It is unclear of the full effect of this provision since lenders could (and likely would) require purchase for properties in their loan portfolio. Regardless, insulating people from the changes related to the maps does not change the geological realities – their property is at risk.

People need to be informed of their flood risk and take steps to financially protect their own investments. To manage that risk, people should purchase flood insurance, if Congress wants to ease the transition then a phase-in of rates is appropriate. It is also unclear how this provision

[15] Sec. 6
[16] Sec. 7

would affect the restriction that properties in covered floodplains that do not purchase flood insurance are ineligible for disaster relief.

Don't Make Matters Worse

In years past there have been efforts to expand the National Flood Insurance Program or create new insurance areas for the federal government. One is the addition of wind insurance, which was wisely – and soundly – rebuffed by the Senate in 2007. We appreciate that the legislation didn't include this provision. It simply doesn't make sense to add a whole new business line to the already challenged flood insurance program.

However, there are some troubling potential expansions of the program in the draft bill. One is the creation of a new insurance product for business interruption or loss of use of personal residence.[17] The former would provide coverage up to $20,000 per property and the latter up to $5,000. With the flood insurance program so heavily in debt it doesn't make sense to expand the coverage provided. While the draft legislation directs the Administrator to not provide the coverage if a competitive private insurance market for it is available, we have learned from federal flood insurance itself that the best way to stifle a private market is to have the federal government provide the same product.

Similarly, the provision in the draft bill that would enable the coverage limits to annually increase by some inflationary measure[18] would result in taxpayers being on the hook for potentially higher and higher loss levels and stifle the development of a secondary insurance market. In addition, it would be very hard to administer. As we have seen over the last several years, residential markets and fluctuations in home values vary dramatically across the country. It doesn't make sense to basically lock in coverage increases annually. One way to move toward a more robust private flood insurance market is to allow the secondary market to provide additional coverage to develop. This provision could easily squelch that.

Conclusion

From Taxpayers for Common Sense's standpoint, there is more that can be done to improve the program. We support the privatization study called for in the legislation, and encourage FEMA to pursue the private-risk management initiatives. It would also be helpful to authorize FEMA to develop a catastrophic reserve to help smooth out minor loss and surplus years without resorting to borrowing.

There must be a strong commitment to help communities and individuals to reduce their flood vulnerability, including stronger standards for floodplain management and mitigation. Congress should end the problem of repetitive loss properties with elevation and relocation programs, increase the availability of accurate information about flood risks, and ensure adequate enforcement of program rules. In too many cases it appears that communities or property owners have skirted existing rules and rebuilt more than 50% of the property while retaining subsidized rates.

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[17] Sec. 4 (c)

[18] Sec. 4 (b)

The National Flood Insurance Program is in trouble and is at a crossroads. The shaky foundation on which it was based has enormous cracks. Congress and the administration can either remake and strengthen that foundation by putting the program on more solid financial footing, or create even greater cracks by adding new business lines or delaying a shift to actuarial rates and updated flood maps.

On balance, the draft legislation is a good step forward to reform the troubled flood insurance program. We look forward to working with the Committee and Congress to move the program in the right direction and off the backs of taxpayers.

Independent Insurance Agent®

STATEMENT OF SPENCER HOULDIN
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE AND HOUSING

UNITED STATES HOUSE OF REPRESENTATIVES

March 11, 2011

Good afternoon Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee. My name is Spencer Houldin, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA or Big "I") to present our association's perspective on efforts to reform the National Flood Insurance Program (NFIP). I am president of Ericson Insurance, a second generation insurance agency with offices in Connecticut and New York. Since 2008 I have served as Chairman of the Government Affairs Committee for the Big "I". I have also represented the state of Connecticut on the IIABA National Board since 2006.

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% 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 considerably more complex than that of many traditional property/casualty lines. Agents must possess a higher degree of training and expertise than their non-NFIP participating counterparts, which requires updating their continuing education credits through flood conferences and seminars. This is done regularly and involves traveling to different regions of the country, costing personal time and money. 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. While IIABA is confident that the NFIP will recover, 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 Chairman Biggert's draft legislation, the Flood Insurance Reform Act of 2011. The IIABA has released a 12-point plan for reform to restore the NFIP to sound actuarial footing, and we are extremely pleased to see a number of IIABA-recommended provisions in this proposed legislation.

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 five 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 supports the five year extension in the "Flood Insurance Reform Act of 2011."

Moving Towards More Actuarial Prices

The Big "I" has for many years asked Congress to explore phasing out subsidies in the NFIP altogether. We are pleased that Chairman Biggert's draft legislation contains proposals to phase out subsidies for many properties. 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 forty-three 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" welcomes and supports Chairman Biggert's ideas on 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.

Finally, the Big "I" welcomes the draft legislation'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 draft legislation would propose to increase this band to 20 percent, which will hopefully allow the program to move even more properties towards actuarially priced rates.

Modernization of Coverages

The Big "I" is very pleased that the draft legislation has chosen to modernize 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 modernization of coverages will hopefully have three positive effects on the NFIP as a whole. First, it will allow consumers to more adequately insure their properties and valuables against their true risks. This will in turn make the NFIP as a whole a more attractive product for consumers, thereby increasing participation in the program. And also, as optional purchases that are sold at actuarial rates, the optional business interruption and additional living expenses additions in particular will result in a NFIP that is closer to being on actuarially sound footing.

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 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.

While the draft legislation allows FEMA to offer these products, it does so with three caveats; that FEMA charges actuarial rates for the coverage, that FEMA makes a determination that a competitive private market not currently exist, and that FEMA certify that these coverages will not result in any additional borrowing from the Treasury. The Big "I" supports the goals of each of these conditions and looks forward to working with the Committee to ensure that these important coverages are made available to those who need it while also adhering to these principles.

Also chief among our recommendations, and present in the draft legislation, 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, as proposed by the draft legislation, 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.

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 the studies on private market capacity as called for in the draft "Flood Insurance Reform Act of 2011." 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.

Repetitive Loss Properties

Repetitive loss properties—currently defined as those that have had two or more flood insurance claims payments of $1,000 or more over 10 years—continue to put a significant drain on NFIP resources. These properties account for about 1 percent of all policies but are estimated to account for up to 30 percent of all NFIP losses. The Big "I" is encouraged that the draft legislation would phase out subsidized rates for these repetitive loss properties, but would urge the Committee to consider taking further measures to combat this difficult issue. For example, if a repetitive loss property continues to experience a certain number of losses within a specific timeframe, Congress could require that property to either take stringent mitigation measures or to be disqualified from participating in the NFIP altogether.

While Congress has previously made efforts to tackle the repetitive loss issue, according to GAO the number of repetitive loss properties has actually grown over the last decade. Dealing with repetitive loss properties is of the utmost importance not only because of the financial strain that they place on the program, but also because of the obvious lack of fairness that these properties highlight to other program participants and the general public.

Conclusion

The IIABA is very pleased that the Subcommittee is conducting today's hearing on comprehensive flood insurance reform and we urge the Financial Services Committee to quickly consider this draft legislation and send it to the full House of Representatives for action. The Flood Insurance Reform Act of 2011 is an essential component in ensuring the long-term stability of the NFIP. We strongly support your efforts to update it to reflect today's risks and market. Adopting the reforms found in the draft legislation would help make the NFIP more actuarially sound and more effective at serving both consumers and taxpayers.

I thank the Committee for giving me the opportunity to express the views of the IIABA on this important program. I 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.

TESTIMONY OF DONNA M. JALLICK
VICE PRESIDENT OF FLOOD OPERATIONS OF
HARLEYSVILLE INSURANCE
ON BEHALF OF THE
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA
BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
ON
THE FLOOD INSURANCE REFORM ACT OF 2011

My name is Donna M. Jallick, and I am the Vice President of flood operations for Harleysville Insurance. Harleysville is an insurance company partner in the National Flood Insurance Program's (NFIP) "Write-Your-Own" (WYO) program. Harleysville Insurance is also a member of the Property Casualty Insurers Association of America (PCI) and the WYO Flood Insurance Coalition.

Introduction

Harleysville and PCI believe that the NFIP is a necessary public policy response to an uninsurable peril and should be continued. Currently, the flood program is set to expire at the end of September this year.

We commend Chairman Biggert and Ranking Member Gutierrez and the rest of the members of this subcommittee for taking up this issue in a timely manner. We would urge you to pass this legislation as soon as possible. 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.

We are also happy to see that the legislation, while making some prudent reforms, does not include wide-spread changes to the program that would result in reauthorization delays while the issues are debated. We believe significant changes to the program should be kept to a minimum and can be debated once the program is reauthorized on a longer term basis.

There are more that 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.

We believe the most important reforms are as follows, and they are addressed in the legislation being discussed today:

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. As I stated earlier, the program is set to expire 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. Homebuyers 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 transactions were delayed because of the NFIP expirations.

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. We are pleased to see that movement toward that end is contained in the legislation.

The legislation includes raising the maximum annual rate increase from 10 to 20 percent. This is critical as we believe, as stated above, that the premiums should reflect the risk of loss. The legislation also increases 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.

We are very pleased to see the inclusion of additional living expenses coverage for residential properties with optional limits as well as optional business interruption coverage. The additional living expenses helps consumers and 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 coverage provided under the flood policy. It has also been the subject of significant problems where there are losses under a flood policy as well as under a private or state policy providing windstorm protection.

We understand the significant issues that have surfaced regarding the certification of levees and the ongoing map modernization efforts. We believe that the phase-in included in the legislation as well as the reestablishment of the Technical Mapping Advisory Committee are important steps in addressing these significant issues for consumers, communities, the states and policyholders.

We are happy to see that Section 10 of the discussion draft includes mitigation grants and addresses repetitive loss properties – both of which are important reforms that should be retained. We believe both are vital to the program, and we very strongly support their inclusion.

Indexing the coverage limits (included in Section 4) is an important provision as well since the maximum limits have not changed since 1994. The limits offered should facilitate replacing the average home based on today's construction costs.

Proposals to end the NFIP's primary flood underwriting are unrealistic given the current steep subsidies and recognized unwillingness of many homeowners to purchase coverage even when mandated and at highly subsidized rates.

Conclusion

We are very pleased that the discussion draft contains a long-term reauthorization of the program, a move toward eliminating rate subsidies, an index of the maximum limits, additional living expense and business interruption coverages and a method to address mapping issues.

Therefore, we support passage of this straightforward legislation and pledge to work with you to improve the National Flood Insurance Program. Thank you.

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TESTIMONY

Legislative Proposals to Reform the National Flood Insurance Program

Subcommittee on Insurance, Housing and Community Opportunity
House Committee on Financial Services

Sally McConkey, PE, CFM, D.WRE
Vice Chair
Association of State Floodplain Managers

March 11, 2011

The Association of State Floodplain Managers (ASFPM) thanks this Subcommittee, Chairman Biggert and Ranking Member Gutierrez, for your attention to the need to reauthorize and reform the National Flood Insurance Program (NFIP). We very much appreciate your holding this hearing and appreciate the opportunity to comment on the discussion draft legislation and to share our thoughts on the current status of the NFIP, challenges the program confronts and opportunities to improve our nation's efforts to reduce flood-related losses.

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 that 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 (FEMA) that point to the need to update those earlier reform and revision proposals and to seriously consider further and possibly significant NFIP reform ideas.

Who We Are

The Association of State Floodplain Managers, Inc. and its 29 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. Our state and local officials are the federal government's partners in implementing flood mitigation programs and working to achieve effectiveness in meeting our shared objectives. Many of our state members are designated by their governors to coordinate 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 website is: http://www.floods.org.

Need to Reauthorize and Reform the National Flood Insurance Program

ASFPM believes the NFIP has been a useful federal program for addressing flood losses in the nation. For the first time, Congress recognized the need for a program that would consider where and how we develop in this nation, rather than engineering our rivers with levees and dams, with resultant loss of natural functions and resources that would naturally reduce flood losses. After 40 years, as with any program, a careful look at whether the program model still works in necessary. But those changes require due deliberation and analysis, using information FEMA is now developing and getting input on significant policy options from all stakeholders.

A reauthorization of 2 – 3 years is important for the stability of the NFIP and the associated predictability is important for lenders, the housing industry, home buyers, policyholders and the Write Your Own (WYO) insurance companies which write flood insurance policies in partnership with FEMA. Numerous recent periods of hiatus in the NFIP's authorization have caused confusion, bureaucratic paperwork challenges, legal worries, frustration (which has resulted in one major insurance company pulling out of the WYO program) and delayed real estate settlements in a difficult period for the housing industry. Reauthorizations of several weeks or months do not provide stability, confidence and predictability.

While a longer period of authorization is important, it must be balanced with the need to fully consider many important reform ideas which will need further evaluation and consideration by the Committee. These, largely involving the status of levees and other infrastructure, the issuance of updated flood insurance risk maps and the affordability of flood insurance, lead to reform considerations that go well beyond the reforms of the earlier legislation.

ASFPM believes that a 2 – 3 year reauthorization would provide the needed reliability while allowing time for FEMA to complete its "Re-Thinking the NFIP" project, including presentation of significant policy and legislative options for management and operation of the NFIP and recommendations to the Congress and the Subcommittee for consideration and action.

Reflections and Questions

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 flood losses in the nation. The NFIP has:

- Required those living at risk of flooding to obtain flood insurance, sparing taxpayers from paying many millions of dollars in disaster relief, and enabling those citizens with flood insurance to more fully restore their lives to normalcy after a disaster. Since 1978, the NFIP has paid over $36 billion in flood insurance claims.

- Prevented some unwise development and promoted flood hazard mitigation through local adoption of floodplain management ordinances. FEMA now estimates that $2.3 billion in losses are avoided annually are due to compliance with these development standards. Additionally, over 20,000 communities have adopted floodplain management standards.

- Funded flood mitigation projects for older, existing at-risk structures. An independent study found that FEMA flood mitigation projects were found to accrue $5 in benefits for every $1 invested in these projects.
- Mapped approximately one million miles of at-risk floodprone areas. This back-bone for the program influences insurance sales, floodplain management, risk communications, and mitigation ensuring that the information and tools are available to assist homeowners, business owners and local governments in making risk informed decisions.

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, yearly flood losses have increased from $6 billion to $10 billion.

The hurricane seasons of 2004 and 2005 involved catastrophic losses well exceeding the average historical loss year, putting the program in debt to the Treasury. The debt now stands at $ 17.75 billion. Due to two mild loss seasons and a favorable refinancing of the debt, the NFIP has been able to repay $2 billion of that debt and the interest. 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. Furthermore, interest on the debt will go up, and the annual program income is only approximately $3.2 billion.

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 more evident. More accurate flood maps now reflect accurate flood hazards if the flood protection of a levee is unreliable or indicates hazard changes from development and storm intensity, new maps show some areas as now in the 100-year flood hazard area. It is important to note that approximately as many properties are newly shown as out of a Special Flood Hazard Area (SFHA) as are newly shown as in the SHFA. The requirement to purchase flood insurance in areas newly shown to be at risk of flooding is highlighting concern about affordability of flood insurance. By the same token, if the new maps do not become effective, those property owners now shown out of the SFHA will still be required to purchase flood insurance.

ASFPM recommends that Congress consider clarifying the intended objectives of the NFIP so that the program can be evaluated accordingly. For example, should the NFIP be expected to accommodate catastrophic losses rather than the average historical loss year? If so, are there realistic, affordable program adaptations that can achieve that objective? If not, would it be best to clarify that the program is not expected to cover truly catastrophic losses?

Other questions warrant examination. What adjustments are needed for the program to be a more positive factor in reducing flood losses in the nation? What adjustments are needed to help communities to act on better risk identification through improved maps? If the NFIP is to be a significant tool in an integrated flood risk management approach, how should it be altered to better support this objective? ASFPM has endorsed the following concepts:

- Integrate the NFIP with other federal flood risk programs, including the disaster relief program, Army Corps of Engineers, Environmental Protection Agency (EPA) and Natural Resources Conservation Service (NRCS).
- Identify cross-program policy conflicts and inappropriate incentives that increase risk.
- Build State floodplain management program capability and capacity to work with the 21,000 participating local jurisdictions
- Delegate the floodplain management and mapping elements of the program to qualified states, similar to programs managed by the EPA and Department of Transportation.
- Identify incentives and disincentives for state and local governments to make the program more effective, since local decisions determine how much development will be placed at risk of flooding.
- Evaluate the NFIP-funded mitigation grant programs to determine whether they are effectively addressing the most high-risk structures.

Other questions that need to be addressed include:

- Should the flood maps better display the flood risk so that communities and citizens understand that the flood risk does not stop at the line on a map – and that considerable risk exists beyond the "100-year" floodplain? (The average home is occupied for more than 100 years, virtually assuring that every home in the 100 year flood hazard area will flood in its lifetime).
- Should insurance be required in residual risk areas behind levees and below dams?
- Should insurance be required in a broader area, such as the 200-year or 500-year floodplain? Should all homeowner policies be required to cover flood?

- Should critical infrastructure like hospitals, fire and police stations and water supply and treatment plants be regulated based on a larger flood, but one the nation experiences somewhere every year, such as the 500-year floodplain?
- Should flood insurance policies be long-term (20 years or more) and tied not to the owner but to the property, regardless of property transfers?
- Should some non-insurance means be identified, such as flood insurance vouchers, to assist lower income property owners and renters with the cost of flood insurance?

Broad Recommendations

The nation must carefully balance the issue of who benefits and who pays for development at risk. It is estimated that there are 130 million housing units in the U.S. Of that about 10 or 11 million are in flood hazard areas. Of those in flood hazard areas, roughly half carry flood insurance. This means 90% of the population does not live in identified SFHAs, but continues to pay a large amount each year for disaster relief for flooding, rebuilding damaged infrastructure in flood areas, and may have 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 other programs like disaster relief programs and programs of HUD, DOT, USDA and others.

ASFPM has identified and grouped several recommendations for consideration by the Committee below.

1. Create a comprehensive national flood risk management framework. To actually reduce flood-related loss of life and property in the nation, we must move beyond the current NFIP minimum approaches toward a true flood risk management framework with the nation's policies and programs. A comprehensive flood risk management program recognizes that:

- Managing flood risk is a shared responsibility between individual, private sector, community, state and federal government;
- Flood risk is not isolated to the 100-year flood hazard area but is rather a continuum of risk that crosses lines on a map; far beyond the shaded area on the flood map;
- Development and other activity outside the 100-year floodplain but in the watershed impacts flood levels—if we only manage activity in that 100-year

floodplain, we miss opportunities to save lives and reduce flood damages and impacts;

- All structural protection measures will fail or be overtopped at some point by some flood event;
- Managing flood risk requires a mix of measures from avoidance to retreat from high risk areas to consideration of structural measures. Selection of only one measure, such as a levee, leads to severe losses in catastrophic events. Levee failure, high storm surge and large flood (500-year) events have shown the need for a combination of approaches including elevation, room for rivers, insurance and structures;
- Flood levels will increase in the future because development increases runoff; and storms are intensifying;
- Flood risk will increase as the natural resources and functions of floodplains are altered by development since this destroys the natural system that reduces the negative impacts of flooding; and
- Flood risk management includes concepts such as identification of flood risk, community planning to steer development away from areas of high risk, basing flood insurance on actual risk, vigorous promotion and support of hazard mitigation actions, and enabling citizens to better recover from disasters by being insured to reduce their financial risk.

The U.S. Army Corps of Engineers has adopted the comprehensive flood risk management approach in many of its programs at the national level, but 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 integrate them with programs of the Corps and other agencies that impact flood risk.

2. Consider bold reforms to address current flood insurance issues. Flood insurance should gradually move toward being actuarially sound to reflect actual risk and enable market-based financial decisions. We recognize that there are affordability problems for some citizens currently living in at-risk areas; this is more prevalent in older riverine areas than in recently developed coastal areas or some newly developed areas behind levees. The de-accreditation of levees and more accurate flood maps have highlighted the affordability issue. We do not support efforts to delay issuance of flood maps, withholding accurate information about flood risk from citizens living and working in hazardous areas. We suggest that this issue presents challenges, but ones that can lead to constructive new growth and adaptation for the NFIP if done correctly.

An insurance program with subsidies is not an insurance program. We understand the need to assist low income people with insurance premiums for some specified length of time, or better yet, to assist them with mitigating their property - upon demonstrated need. One alternative would be a program of flood insurance vouchers to assist with purchase of flood insurance issued through a means-tested program could be administered by the Department of Housing and Urban Development. An analysis might show it would be less costly for the taxpayer to pay for flood insurance vouchers for low income property owners rather than have the taxpayer continue to pay disaster costs from the Disaster Relief Fund every time that a community floods. Insurance can also be applied toward mitigation of their property after a disaster.

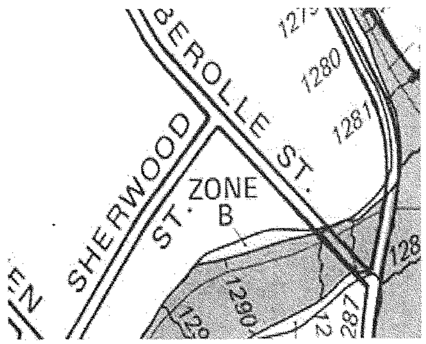
If short term relief is provided using the NFIP-- through delayed mandatory purchase of insurance, extension of time when policies can carry Preferred Risk rates, or phase-in of actuarial rates; it must be recognized that none of these are appropriate long term solutions—somebody in the nation will pick up those costs, mostly the federal taxpayers. In conjunction with such short term relief, FEMA should provide general information about actuarial rates so people see what their true risk is, and at the same time, provide substantial information about mitigation actions and how much each action will reduce actuarial premiums in the future.

Another alternative would be the the development of group flood insurance which could be developed by FEMA for mapped flood hazard areas and areas mapped as protected by a levee, allowing a group policy to be purchased by the levee district or other local taxing entity for all residents of the area, thereby keeping costs down. Remember, the more policies there are the lower the premiums everyone pays.

3. Recognize the need for a continuous, authorized long term flood mapping program. Flood mapping has changed significantly over the life of the program. Better technology, improved methods, and the creation of risk assessment techniques not only allow for the identification of flood hazard areas but also enables the creation and distribution of data that allows business and home owners to make appropriate risk decisions. Map Modernization recognized that good mapping was important to many facets of community actions such as warning and evacuation, highway construction, location of hospitals, etc, and was broadly supported by engineers, realtors, home builders, environmental and many other organizations that recognized the multiple benefits of having modern, current, and maintained flood maps.

Flood mapping today is a far cry from flood mapping 30 years ago. In those days, flood maps showed the boundary of the flood hazard area and a base flood elevation that made sense to surveyors and local officials, but not many other people. Figure 1 illustrates one such map.

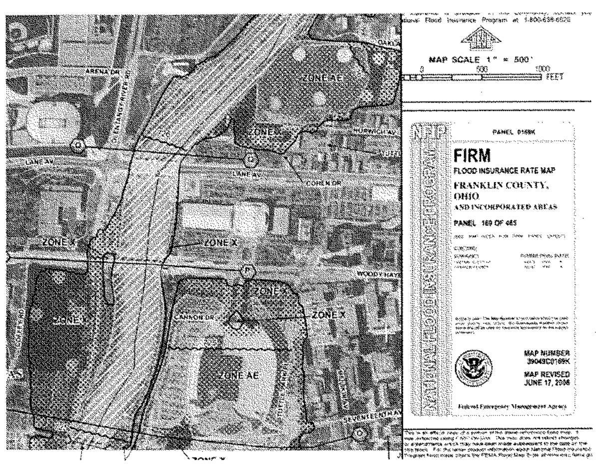
Figure 1. Old Style Flood Insurance Rate Map (FIRM)



The data shown on older FIRM's, while accurate made it difficult to see the locations of individual structures in relation to the floodplain.

In this past decade and with FEMA's Map Modernization program, many of the nation's flood maps were converted to a common and digital format, improved with new base mapping, and some new engineering studies updated the flood data. These maps, shown in Figure 2 became much more usable for the general public.

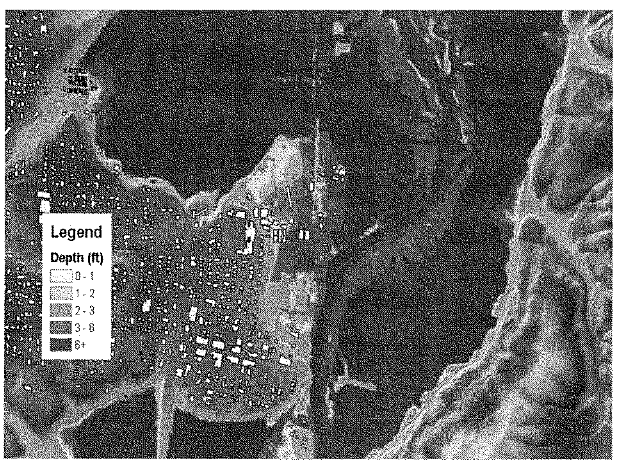
Figure 2. New Style FIRM



These new style FIRMs show individual buildings, streets and are in a format that is easily accessible and electronically available so more people can use them.

The most recent, and promising version of FEMA's mapping program is Risk MAP. Because it is less than two years old, products are just beginning to be generated. The significance of FEMA's Risk MAP program going forward is that it marries flood mapping with flood risk assessment information. Three new products, a *Flood Risk Map, Flood Risk Report,* and *Flood Risk Database* will be provided in addition to the FIRM and Flood Insurance Study. Why is this important? Because the additional data provided under Risk MAP will allow homeowners, business owners, and government officials to take actions to reduce flood risk. For example, loss information provided in the flood risk report can assist local emergency managers in prioritizing where to focus resources during and after a flood. Flood depth grids use darker to lighter shading in the 100 year floodplain to show how deep the flood water will be at a given point on the ground (Figure 3).

Figure 3. Flood Depth Grid



As a result of the continuous improvement in FEMA's flood maps, the maps today are more accurate, provide better and more usable data to communities and citizens, and are more portable than ever before. The Risk MAP process is also designed to have more input and meetings with communities and citizens so the map products will better reflect community needs. While ASFPM acknowledges that there will be some ongoing mapping issues, conceptually, FEMA's Risk MAP program is an appropriate future direction for flood risk mapping. ASFPM recommends that a permanent authorized flood mapping program be included in any NFIP legislation.

Related to flood mapping, there have been recent concerns related to the mapping and accreditation of levees. First, it is important to note that flood risk exists behind levees. This position is supported not only by ASFPM but also by FEMA, US Army Corps of Engineers and other organizations such as the American Society of Civil Engineers. This risk exists regardless of whether FEMA maps areas behind levees as flood hazard areas or not. The risk is partially borne by those that choose to occupy that area but along with that decision it drags along the tax payers that pay for disaster assistance and fund the rescue missions when that levee is overtopped or fails. While the failure or overtopping of an individual levee may not happen frequently, every year there are multiple examples of these kinds of failures inevitably resulting in a taxpayer bailout. It is time to better recognize, manage, and more directly apportion the cost of this behavior to the individual that opts to live behind a levee as well as the community who benefits from development and the general taxpayer. ASFPM understands that FEMA is working on various approaches to how to characterize the flood risk that exists behind levees, but ASFPM firmly believes that flood risk behind levees is real, it should be mapped, everybody informed and flood insurance should be required in those areas.

4. Make improvements in floodplain management and hazard mitigation elements of the NFIP. Hazard mitigation programs under the NFIP were established after the 1994 Reform Act in recognition of the need to address older, at-risk structures. After the 2004 Reform Act, two additional programs were created focusing on repetitive loss properties. Such properties, while comprising only 1% of the policies under the NFIP result in over 30% of the claims. Of these two programs, the Severe Repetitive Loss Program (SRL) has been underperforming. ASFPM believes the reason for this is the extremely prescriptive and nearly unworkable statutory language authorizing the SRL program. FEMA had nearly no latitude to write implementation rules to allow the program to function and as a result, the program has been significantly undersubscribed since inception. The issue of repetitive loss properties is as significant today as it was in 2004 and ASFPM recommends that as part of any NFIP reform package, the SRL program be significantly streamlined and focused on mitigating repetitive loss properties.

For the second time in ten years, FEMA has had a call for issues that includes a discussion of minimum land use and development standards of the NFIP. While we understand it takes a long time to identify potential changes and begin rulemaking, ASFPM is frustrated that the minimum building standards of the NFIP haven't been changed or improved in over 20 years. In that time period, new data and several studies, including a comprehensive evaluation of the NFIP and stakeholder input has suggested several sensible enhancements to these standards that will further reduce flood losses and meet the intent of the NFIP. The Subcommittee should have an interest in knowing

FEMA's plan for updating the minimum standards of the NFIP and encourage periodic reporting of progress.

Perspectives on the National Flood Insurance Program

FEMA reports that the NFIP has been self-supporting for 20 years. From 1986-2005, prior to Hurricane Katrina, income from policyholders covered claims and all operating expenses, including salaries and expenses of the Federal employees who administer the NFIP and floodplain management programs. From time to time the NFIP exercised its authority to borrow from the U.S. Treasury when claims exceeded short-term income. Importantly, the program was praised for its ability to repay debts ahead of schedule and with interest. This would seem to be the way Congress intended the program to function. The original framers did not require the NFIP to set rates for truly catastrophic flood year associated with single extreme events like Hurricane Katrina or in a year where there cumulative large events that in total were catastrophic, 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 doesn't occur because buildings have been built to resist flood damage. FEMA does estimate that meeting the NFIP standards prevents over $2 billion in damages each year. Perhaps the original framers considered it reasonable that taxpayers contribute to payment of claims after extreme events that exceed the NFIP's capacity to pay as part of the bargain for long-term overall improvement in the way we manage flood losses—perhaps Congress could clarify this.

The NFIP has multiple goals, and providing flood insurance in order to minimize direct government subsidy of flood damage is one of the goals. The consequence of having fewer people insured against known risks would likely be greater reliance on taxpayer funded disaster assistance and casualty loss tax deductions. Striking the balance between a fiscally sound NFIP while having premiums that are affordable – but that do not reward or encourage development in high flood risk areas – is the challenge now facing Congress and the nation.

The National Flood Insurance Program is now 42 years old. It was created in 1968 by the Congress following several major studies in the 1950s and 60s, after which studies concluded that the private sector did not offer insurance coverage for flood because only those who had actually flooded would buy policies, contrary to a normal insurance model which assumes a broad spreading of risk to cover losses. The lack of information showing which properties were likely to flood added to the private sector dilemma, which is less of a challenge now that FEMA produces flood maps for 21,000 communities. The concepts embodied in the NFIP were designed with the idea it would save the taxpayers' money in disaster relief by requiring those living in at-risk locations to pay something to cover their own risk, and to enable them to more fully recover from flood damage than they could with only disaster relief. The assumption was that this would reduce flood losses over time by requiring local regulation of development in flood hazard areas as communities voluntarily agreed to participate in the program in order to make flood insurance available to community residents and businesses.

The NFIP has gone through various stages of growth and adaptation involving more, then less, then again more involvement with private insurance companies and agents. After its first five years, Congress added mandatory purchase of flood insurance in identified flood hazard areas. By 1979, the program moved from the Department of Housing and Urban Development (HUD) to the newly established Federal Emergency Management Agency (FEMA). Initially some 70% of insured properties had discounted policies because they were "grandfathered" since they were built before the flood hazard area was identified. Now about 23% of insured properties have these discounted rates. Many newly developed properties have been built either in safer locations outside the 100-year floodplain or built to NFIP standards (elevated to the 100-year flood level) to mitigate possible flood losses.

During the 1980s, the goal of making the program self-supporting for the average historical loss year was achieved, but the premiums did not provide sufficient income to develop and maintain accurate flood maps for 21,000 communities. There were no Congressional appropriations for the program from 1986 until 2003, when it was agreed the nation needed a major map modernization effort requiring appropriated funds. Most of the nation's flood maps were found to be 10 to 20 years old, not reflective of massive watershed and floodplain development, and therefore not accurately representative of actual flood hazards.

A major report following the Midwest floods of 1993 found that only 10-15% of damaged properties had flood insurance. This led to another set of improvements in the National Flood Insurance Reform Act of 1994, including stricter compliance requirements for lenders and new means of encouraging and supporting mitigation through the Increased Cost of Compliance insurance coverage, establishment of the Flood Mitigation Assistance program and authorization of the Community Rating System to make lower premiums available in communities taking significant steps beyond national minimum approaches to mitigate risk. The Flood Insurance Reform Act of 2004 Act made a number of improvements to insurance agent training and consumer provisions, and enhanced and developed programs to address the problem of repetitive flood losses.

A major and the first ever full evaluation of the NFIP was commissioned by FEMA in 2000 and was led by the American Institutes for Research with contributions from other research entities. That report was delivered to the Congress in 2007 when the Congress was well on its way to development of the '07 and '08 House and Senate versions of flood insurance reform legislation. As a result of this unfortunate timing, the findings and recommendations of this significant NFIP Evaluation were never fully examined by the Congress.

The House passed a bill in 2010 that was derivative of the 2007 House passed bill. There has been no significant legislation enacted to reform the NFIP since 2004.

Observations on the Discussion Draft

The Discussion Draft developed by the Subcommittee includes a number of important and helpful changes to the NFIP and to the bill passed by the House last summer. We note that these constitute revisions rather than reform and would urge the subcommittee to change the title to reflect this and to plan on in depth consideration of significant policy and legislative recommendations for the NFIP anticipated to be presented to the Congress by FEMA early this summer. While there are certainly exceptions, a number of the provisions of the draft are likely to increase the exposure of the taxpayers for costs from flooding, instead of ensuring that those costs are borne by those who live or build at risk. This causes concern for ASFPM.

We understand that the modernization and updating of FIRMs, the de-accreditation of many levees and questions about mapping of flood risk associated with them and with non-levee embankments and the affordability of flood insurance have generated much concern among citizens and their Congressional representatives. Additionally the current debt to the Treasury resulting from catastrophic losses raises concerns about the structure and viability of the program. These challenges offer an important opportunity to make major reforms to the program to better reduce flood losses, protect citizens living at risk of flooding and protect the American taxpayer. While this bill cannot address all of these challenges in the short time before the program's current authorization will lapse, we think it is important to note that the discussion draft does not address key underlying issues:

1) Affordability concerns which are interfering with risk identification, mitigation and protection of property through insurance which provides for a speedy, more full recovery after a flood disaster.
2) Catastrophic losses, the current and potential additional debt to the Treasury and whether or not the NFIP should be structured to meet that level of need.

Length of Authorization (Section 2)

We urge the Subcommittee to reauthorize the NFIP for 2 or 3 years rather than the 5 years included in the draft. This would ensure a stable authorization period, avoiding frequent program lapses, while also ensuring that timing will facilitate full consideration of FEMA's expected recommendations for the future direction of the program.

Mandatory Purchase Delay Modifications (Section 3)

ASFPM appreciates that the proposal attempts to modify and tighten previous proposals to delay the mandatory purchase requirement for properties in areas newly mapped as floodplain; however, we also find it highly problematic from an implementation standpoint as written. H.R. 5114, passed by the House last summer, had provided a 5-year delay for all such areas nationwide to be followed by a 5-year phase-in of actuarial premium rates for those properties. ASFPM objected to the delay of mandatory purchase because if the risk is known and documented, it is not appropriate for the federal government to help people ignore their risk. This not only does not protect those people, but gives the burden of assistance in the event of a flood disaster to the general taxpayer. While we suggest there be no delay in mandatory purchase we do appreciate the subcommittee has attempted to target this exemption more tightly to specific kinds of situations for a more limited period of time. We note that including this kind of detailed process in legislation is always problematic for agency implementation.

From an implementation standpoint we believe the burden and cost to implement this measure will be significant. What exactly is an "area" as used in the draft? Conceivably an area could be as small as a single lot or property leading to potentially tens of thousands of exceptions that would need to be tracked, each with its own schedule of 1, 2 or 3 years. Based on current practices, it appears that for every mortgage transaction it would be necessary to do a determination based on the current map, a determination based on the previous map, and then some type of research to determine if an exception is in place for that specific property (the ease of which will be directly related to the new funding provided by congress to track this in a data base by the NFIP). This may result in increasing the cost to every consumer who secures a mortgage and the ability to process a timely determination may slow closing. The Committee might wish to explore this issue with the lending and determination industries.

Reforms of Coverage Terms (Section 4)

ASFPM agrees with the proposal to use differentiated deductibles for pre and post-FIRM properties. The use of a higher deductible for pre-FIRM properties seems to be a reasonable move to, in effect, reduce the subsidies for such properties. Our lack of comment on other elements of this section should not be construed as either support or concern.

Phase-In of Actuarial Rates (Section 5)

The perceived need for this provision is strongly related to concerns about affordability of flood insurance. We understand the motivation to lessen the impact of a newly imposed flood insurance requirement, but must point out that the National Flood Insurance Fund will have full exposure for coverage of claims from the affected properties without the benefit of full premium income. If there is no insurance, the disaster relief program is exposed for those damages. Both of these then expose the federal taxpayers.

We would prefer that the Subcommittee consider another method of addressing the affordability issue outside of the insurance mechanism, such as a means tested flood insurance voucher system to be handled by the Department of Housing and Urban Development. We suggest that the Subcommittee draft include at least a study of the economics of providing lower income property owners with vouchers to assist with the purchase of flood insurance versus the assumption by taxpayers of the costs of disasters affecting lower income citizens. Consideration of how insurance will speed restoration of economic vitality and restoration of citizens to their homes should be part of that study.

It is also important to recognize that many levees will not be brought up to meet the NFIP standards. ASCE estimates that it will take $50 billion to simply repair the existing levees in the nation that are not properly maintained. Funding for that is not available now, and likely will not be for decades, if ever. As such, should Congress consider how to protect the financial means of those living behind levees. Might it be less expensive to provide insurance than to try to bring all levees up to some standard they do not meet. In the meantime, the levees will provide whatever protection they can for some events, but we also recognize they will overtop or fail in large events?

Under "Phase-In of Actuarial Rates for Certain Properties, we agree with all listed categories with the exception of (6) Homes with Multiple Claims. The 2004 Flood Insurance Reform Act established the programs for dealing with repetitive loss properties. If deemed cost effective for the National Flood Insurance Fund, an offer of mitigation assistance is to be made to such properties. If such an offer is refused, the penalty would be incremental movement toward actuarial rates. Including all severe repetitive loss properties in moving to actuarial rates would capture even repetitive low-level losses, because the trigger for SRL designation is 4 losses, even if low cost. This provision could be seen as punitive.

Under "Prohibition of Extension of Subsidized Rates to Lapsed Policies," we would question how FEMA could determine whether or not the lapse resulted from a "deliberate" choice. Further, we are concerned that this increase to actuarial rates for re-purchase of a lapsed policy could serve as a significant disincentive to reinstate coverage.

Technical Mapping Advisory Council (Sections 6 and 7)

ASFPM very much supports the re-establishment of a Technical Mapping Advisory Council (TMAC). Such a Council was established, also for a 5 year period, by the Flood Insurance Reform Act of 1994. The report and recommendations of that Council were influential in the development of a Map Modernization Presidential Initiative implemented in 2003. That Council's role was advisory and we recommend that the role of this new TMAC also be substantively analytical and advisory.

The role of the TMAC should be as an advisory council to provide stakeholder input to the needs and uses of maps to assist FEMA in improving its processes. The listed membership include some mapping experts, but most members are not flood mapping experts , so actually setting mapping standards for FEMA would be outside their experience and expertise, while providing professional advice would be very appropriate and helpful. Given rapid changes in mapping technology, this proposed system would not allow FEMA the flexibility needed to incorporate new methodologies and move beyond standards that may be quickly overtaken by new developments. We also suggest that the draft language reiterates the TMAC provide recommendations on the "best methods" in a number of areas. We would urge that the language needs to include guidance that the solutions be also practical, cost effective, and meet the mapping needs for the program. Our concern is, (and this being from a membership that includes a large number of Professional Engineers), that if the goal is to develop the best, we can spend significant resources to develop the best but in the end the answer may not be significantly different than a more cost effective approach.

We urge that the membership list be amended to include "a representative of State national flood insurance coordination offices". This category of membership was named in the 1994 Flood Insurance Reform Act creating the first TMAC and was also included in both the House and Senate passed versions of flood insurance reform legislation in 2007 and 2008 respectively. It might also be useful to consider the addition of State hazard mitigation officials as well since the current and future focus of flood mapping includes risk assessment information.

Section 7 includes perhaps too much prescriptive detail , but we suggest that it be more reflective of information needed by communities and mitigation planners for performing their jobs of reducing flood losses. For example, the section provides for mapping only the 100 year and 250 year floodplains. FEMA and its partners would benefit from inclusion of the 500 year floodplain as well as the 2, 5, 10, 50 year floodplains. The 250 year is not a commonly used value.

Privatization Initiatives (Section 8)

ASFPM has always been supportive of periodic program evaluations and exploration of alternative approaches. While ASFPM supports more in-depth studies of privatization, we must also be clear that the NFIP is not just an insurance program and previously in this testimony have highlighted successes related to the development standards of the NFIP. Any such movement in this area must ensure that there is a mandatory *quid pro* *quo* for adoption and enforcement of comprehensive floodplain management standards. We would urge that Congress direct this study to include data from contemporary international attempts to implement private flood insurance such that we can incorporate the lessons learned.

Community Building Code Administration Grants (Section 11)

ASFPM is supportive of grants specifically to train local building officials in the applications of the NFIP. However, funding staff and other operational elements in order to pay for the inspection of development that primarily benefits that community does not seem appropriate. Many communities across the nation charge impact fees and permit fees such that development pays its own way and this principle is equally sound when applied to the inspection of a variety of issues in the community including the NFIP. Providing some incentive for communities who do this would seem appropriate, and how to do that is the issue. Perhaps through sliding cost share for mitigation grants or disaster relief. It would need to require not only adoption of the best codes, but full enforcement of those codes.

Other Recommendations

If the Committee is to be able to consider subsequent major reform of the NFIP, we would suggest that two other studies would be in order in addition to the privatization initiatives already provided for in this discussion draft:

1) A study of the feasibility of group insurance -- for entire communities, for identified Special Flood Hazard Areas (SFHAs) or for residual risk areas behind levees, and

2) An economic analysis 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 economic vitality and speed of rebuilding, repair and restoration.

The Severe Repetitive Loss Program is one of two mitigation programs within the NFIP focusing on repetitive loss properties has not been effective in utilizing available funds. It appears that this is largely because the statutory provisions establishing the program were so prescriptive that FEMA's ability to design an effective program was limited. Because this program is needed to assist in reducing the approximately $200 million per year drain on the National Flood Insurance Fund, we recommend that the Subcommittee investigate the impediments to effective functioning and develop legislative corrections.

Conclusion

ASFPM is grateful for the opportunity to share our thoughts with the Subcommittee and hope they will be helpful as you move forward with legislation. We will be glad to respond to any questions and to assist the Subcommittee in any way that we can. For further information or assistance please do not hesitate to contact me (sally@illinois.edu), ASFPM Executive Director Larry Larson (larry@floods.org), or ASFPM Washington Liaison Merrie Inderfurth (inderfurth@aol.com).

RAA

REINSURANCE
ASSOCIATION
OF AMERICA

STATEMENT

TESTIMONY

OF

FRANKLIN W. NUTTER
PRESIDENT
REINSURANCE ASSOCIATION OF AMERICA

LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON
INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

MARCH 11, 2011

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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% of the losses related to the events of September 11, 2001 were absorbed by the global reinsurance industry, and in 2005 61% 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 post-event 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 re-establish 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 US 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 twenty 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% of policies and 25-30% of losses. The Congressional Budget Office (CBO) reports the number of repetitive loss properties has increased by 50% 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% 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% 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% 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% 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 non-competitive. 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 US 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 re-authorization 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.

NAMIC®
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of

Sandra G. Parrillo

President and Chief Executive Officer

The Providence Mutual Fire Insurance Company

on behalf of the

National Association of Mutual Insurance Companies

to the

Insurance, Housing and Community Opportunity Subcommittee

of the

House Financial Services Committee

hearing on

The National Flood Insurance Program

March 11, 2011

The National Association of Mutual Insurance Companies is pleased to offer comments to the Insurance, Housing, and Community Opportunity Subcommittee on the National Flood Insurance Program (NFIP).

My name is Sandra G. Parrillo. I offer my testimony to the Subcommittee as the chairman of NAMIC and as the president and chief executive officer of The Providence Mutual Fire Insurance Company. As New England's oldest mutual fire insurance company, The Providence Mutual was chartered by the General Assembly of Rhode Island in 1800. Today we provide personal and commercial insurance protection to more than 65,000 policyholders in New England, New York, and New Jersey. The Providence Mutual currently employs approximately 75 individuals, is represented by over 300 independent agencies, and is based in Warwick, RI.

NAMIC believes that: (1) there are significant problems with the NFIP as it is currently structured and (2) the best solution involves reforming and optimizing the program. The views I will share with the Subcommittee are based on my own 34 years of experience in the property/casualty insurance industry and 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 easy to predict. 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, and the pool of insureds 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 1920's and 1930's 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% of all flood policies are written through WYO companies. The partnership has proven to be remarkably 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 December 31, 2009, the program had 5.7 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 non-actuarial 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% 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 – and currently carries – almost $20 billion in debt.

Optimization of the NFIP

Under the current circumstances, it is not surprising that policymakers would raise questions about the future direction of the NFIP. Clearly the status quo is unacceptable. However, I would 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, most effective, and 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 re-authorization 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 non-primary 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 one 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.
- Within six months of TMAP recommending new mapping protocols, FEMA should begin updating maps based on the recommendations.
- Within five 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 sub-set 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 seven 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 in 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 non-compliance.

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.

I would like to thank the subcommittee for its work on the discussion draft of the Flood Insurance Reform Act of 2011 that was recently circulated. We believe that the proposed bill takes several positive steps forward and coincides with 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.

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[1] Smarter Safer Coalition Flood Proposal, February 22, 2011. www.SmarterSafer.org
[2] Government Accountability Office; GAO-11-278 *High-Risk Series. An Update*, p. 167-170

Testimony of
Barry Rutenberg

On Behalf Of the
National Association of Home Builders

Before the
United States House of Representatives
House Financial Services Subcommittee on Housing and Community Opportunity

Hearing on
Legislative Proposals to Reform the National Flood Insurance Program
March 11, 2011

NAHB
National Association
of Home Builders

Introduction:

Chairman Biggert, Ranking Member Gutierrez and members of the Subcommittee on Insurance, Housing and Community Opportunity, I am pleased to appear before you today on behalf of the more than 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 Subcommittee on this important issue. My name is Barry Rutenberg; I am a home builder from Gainesville, Florida and First Vice Chairman of the Board of the National Association of Home Builders (NAHB).

NAHB commends the subcommittee for addressing reform of the NFIP program. First and foremost, NAHB strongly supports a five-year program reauthorization. We believe a five-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 undergone 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. Unfortunately, during this time between authorization periods, many homebuyers faced delayed or cancelled closings due to the inability to obtain flood insurance for their mortgages. In other instances, builders were forced to stop or delay construction on new homes due to the lack of flood insurance approval, adding unneeded delays and job losses. NAHB believes a five-year program will help ensure the nation's real estate markets operate smoothly and without delay. We therefore commend the subcommittee 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 any floodplains. In addition, if a local government deems an area fit for residential building, flood insurance and mitigation standards allow homebuyers 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 helps ensure the members of the housing industry can continue to provide safe, decent, and affordable housing to consumers.

The NFIP provides flood insurance to over 5 million policyholders, enabling them to protect their properties and investments against flood losses. Further, the NFIP creates a strong partnership with state and local governments by requiring them to enact and enforce floodplain management measures, including building requirements that are designed to ensure occupant safety and reduce future flood damage. This partnership, which depends upon the availability of comprehensive, up-to-date flood maps and a financially-stable federal component, allows local communities to direct development where it best suits the needs of their constituents and consumers. This arrangement has, in large part, worked well. Unfortunately, the losses and devastation suffered in the 2004 and 2005 hurricane seasons, have severely taxed and threatened the solvency of the NFIP.

According to FEMA, since the NFIP's inception in 1968 through 2004, a total of $15 billion has been needed to cover more than 1.3 million losses. The 2004 hurricane season required close to $2 billion dollars in NFIP coverage, and the 2005 hurricane season resulted in payments totaling over $13.5 billion. Combined claims for these two years exceeded the total amount paid during the previous 37-year existence of the NFIP program. In addition, the Midwest floods of 2008 further burdened the floundering NFIP. While these losses are severe, they are clearly unprecedented in the history of this important program and, in our opinion, 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 implement needed reforms including the possibility of privatizing the NFIP.

While NAHB supports reform of the NFIP to ensure its financial stability, it is critical that Congress approach this legislation with care. The NFIP is not simply about flood insurance premiums and payouts. Rather, it is a comprehensive program that guides future development and mitigates against future loss. While a financially-stable NFIP is in all of our interests, the steps that Congress takes to ensure 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.

NAHB Supports Thoughtful NFIP Reforms:

The unprecedented losses suffered in 2004 and 2005, including the devastation brought about by Hurricanes Katrina, Rita and Wilma, have severely taxed and threatened the solvency of the NFIP. While these events have been tragic, sobering, and have exposed shortcomings in the NFIP, 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 this Committee, FEMA is completing its map modernization effort aimed at digitizing, updating, and modernizing the nation's aging flood maps. While FEMA was successful in digitizing most of the FIRMs, many are not based on updated hydrologic data. Likewise, a 2007 National Academy of Sciences report faulted some of the maps because of a lack of reliable topographical data. As a result of these shortcomings there remain large discrepancies between what was mapped as the 1% annual chance of flood decades ago and what the 1% annual chance of flood is today. While FEMA is currently addressing this oversight through the efforts in its RISKMAP program, we believe continued Congressional oversight is necessary. The establishment of a Technical Mapping Advisory Council, as suggested in the Subcommittee's discussion draft, is an important step in ensuring the scientific validity of the maps, as well as ensuring that they reflect the true risks to property. We are hopeful that such a council, if approved, would also result in improved collaboration and coordination among the agencies and the private sector, and lead to a regular dialog to further 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 the legitimate losses will be covered and benefit 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 NFIP.

NAHB also 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 is the mandatory purchase of flood insurance for structures located behind flood control structures, such as levees or dams. The second is that all structures within the 1% annual chance flood obtain flood insurance regardless of whether or not they currently hold a mortgage serviced by a federally-licensed or insured carrier. Both of these strategies would increase the number of residences participating in the NFIP, buttressing the program against greater losses. While these options seem simple, in reality, they are much more complicated.

The NFIP and its implementing provisions were not created solely to alleviate risk and generate premiums -- they were created to balance the needs of growing communities with the need for reasonable protection of life and property. 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.

Second, FEMA must better coordinate its activities with those of other federal agencies who have oversight of other federal programs. For example, FEMA recently began requiring (under Procedure Memorandum No. 64) certain property owners to demonstrate compliance with the Endangered Species Act (ESA) prior to FEMA issuing them a Conditional Letter of Map Revision. 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 the potential for project delays, increased costs to construction, and an ultimate impact on 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 that before any reforms are enacted to change the numbers, location, or types of structures required to be covered by flood insurance, FEMA should first demonstrate that the resulting impacts on property owners, local communities, and local land use are more than offset by the increased premiums generated and the hazard mitigation steps taken. Only after documentation is provided indicating 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.

NAHB is Concerned with Potential Negative Reforms:

As Congress considers strategies to ensure the availability of insurance and to bolster the financial stability of the NFIP, NAHB cautions against those reforms that have obvious far-reaching and unintended consequences, including reforms that decrease housing affordability and the ability of communities to meet current and future growth needs. For example, we are pleased that the Subcommittee's discussion draft recognizes the financial burdens the NFIP places on homeowners and specifically allows premiums to be paid in installments and rates to be phased-in for newly mapped areas; however, NAHB is concerned about the challenges that could arise from allowing annual premium increases to rise from 10 to 20 percent – especially given today's fragile economy. We are equally concerned about any changes that would expand the Special Flood Hazard Area (SFHA) beyond the 1% annual chance flood, fail to take into account flood-protection structures when setting premiums, or expand the current federal minimum residential design, construction, and modification standards.

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. For example, changing the SFHA from a 1% annual chance flood (100-year) standard to a 0.4% annual chance flood (250-year) standard 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 complied with the 1% annual chance standard will suddenly find themselves below the design flood elevation for the 0.4 % annual chance of flooding. Although these structures may be grandfathered and be able to avoid higher premiums as a result of their non-compliant 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.

In addition, any revision of the SFHA standard would not only affects 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 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 a newly-designated SFHA would need to be notified through systematic outreach efforts. Communities would likely need to modify their floodplain ordinances and policies to reflect the new SFHA. In short, the entire infrastructure of flood management and mitigation practice and procedures institutionalized around the 1% standard would need to change, all at a time when FEMA has admitted its lack of resources to provide current services.

Although a revision of the 1% chance of flood SFHA standard has been considered in recent years, even specially-convened policy forums have failed to reach consensus on the issue. What has started to emerge, however, is the recognition of the tremendous implications that changing the SFHA would have on home builders, homebuyers, communities, and the federal government itself. NAHB strongly cautions against making such sweeping changes to the NFIP without first having all the facts in-hand. Only after Congress and FEMA have adequately documented that a drastic revision of the SFHA is absolutely necessary to the continued existence and operation of the NFIP, should a programmatic revision of the SFHA be seriously considered.

Another important component of the NFIP is the ability of communities, with the assistance of the federal government, to design, install, and maintain flood protection structures. In most instances, residential structures located behind dams or levees providing protection to the 1% annual chance of flooding are not currently required to purchase flood insurance. This is because most structures are removed from the SFHA on the relevant FIRM or through the Letter of Map Revision, or LOMR, process. Accordingly, any reforms that contemplate bringing these same residences back under a mandatory purchase requirement raise very real and powerful equity and fairness issues. If Congress or FEMA produces 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 have been invested to provide additional flood protection (i.e. dams and levees) to these residences, and it is only fair that homeowners in these areas, if required to purchase insurance, be recognized for their communities' efforts.

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 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.[1] 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 homebuyers. NAHB urges Congress to soften the impact of any programmatic changes to the NFIP by ensuring that construction requirements remain tied to the 1% annual chance flood standard.

Finally, FEMA reports that more than 78% of policyholders are already paying actuarial (risk-based) premiums.[2] Nevertheless, NAHB believes any 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

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[1] 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)

[2] Federal Emergency Management Agency, *Actuarial Rate Review: In Support of the October 1, 2010, Rate and Rule Changes*, (July 2010) p. 22. (See Appendix)

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.

NAHB
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.

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[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.

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[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

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BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

HEARING REGARDING

LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM

MARCH 11, 2011

Introduction

Chairwoman Biggert, Ranking Member Gutierrez, and members of the Subcommittee, on behalf of the more than 1.1 million REALTORS® who are engaged in all aspects of the residential and commercial real estate sector, thank you for inviting me to testify today regarding draft legislative proposals to reform the National Flood Insurance Program (NFIP).

My name is Terry Sullivan. A REALTOR® since 1970, I am broker/owner of Sullivan Realty Inc. in Spokane, Washington. For most of my professional career I have been involved in land development as well as residential real estate. I have also been active within the National Association of REALTORS® (NAR) for 17 years, holding significant positions at both the state and national levels. Since 1994, I have been a member of the NAR Board of Directors and served as President of the Washington State Association in 2006. Currently I serve as chair of NAR's Land Use Committee which has jurisdiction over the NFIP.

The NFIP ensures access to affordable flood insurance for 5.6 million American home- and business owners. This protection is vitally important as annual flooding claims dozens of lives and billions of dollars in property loss, making it the most common natural disaster in the United States. By law, flood insurance is required 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 property and money.

NAR strongly supports the provision of the draft bill to reauthorize the NFIP for a full five years, ending the current stopgap approach that has only exacerbated uncertainty in recovering real estate markets. Since September 2008, authority for the NFIP has been extended **nine** times and **twice** was allowed to expire for multiple weeks at a time, immeasurably shaking consumer confidence. In June 2010 alone, this resulted in the delay or cancellation of 47,000 home sales according to NAR survey data. While we do have concerns with some of the draft's reforms, we support the Subcommittee's overall approach to reauthorize the program long-term before current authority is set to expire on September 30 of this year and share the goal of strengthening the long-term viability of this critical program.

Before turning to specific reforms, I would like to address several common myths about the NFIP as well as its legislative history. 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. Data also does not support assertions of a cross subsidy from non-coastal to coastal states nor a cost to taxpayers from reauthorizing the NFIP. The private market would guarantee neither the availability nor the affordability of flood insurance along rivers, the relatively few coastal areas where NFIP is legally permitted, or anywhere else that rain falls. Without this program, the only way for many owners to rebuild after a flood would be for the federal government to provide post-disaster rebuilding assistance – using taxpayer dollars.

Legislative History

The NFIP was created in 1968 after Hurricane Betsy because there was no market alternative for flood insurance. Historically, most communities were built along rivers as well as coastlines. Because flood victims could not turn to a private market to insure and pre-pay for the flood damage, 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 with yet another 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 is 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 program shave 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 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 again on the verge of approving a subsequent bill (H.R. 3121, the Flood Insurance Reform and Modernization Act), but did not hold a conference as attention turned to the problems facing the U.S. financial system. We thank the members of the House of Representatives, and particularly this subcommittee, for returning to the subject in the last Congress, by approving the Flood Insurance Reform Priorities bill, H.R. 5114. Ultimately the 111th Congress failed to complete its work on the legislation and the NFIP's authority had to be extended for the ninth time, following a total of five lapses since 2008, and two just last year for several weeks each lapse. At this time, the program is again set to expire on September 30th of this year.

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.

Common Myths

Before turning to the draft reform bill, I would like to address several misconceptions about the NFIP. 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 along rivers, the relatively few coastal areas where NFIP is legally permitted, or anywhere else that rain falls. 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 taxpayer-funded disaster relief.

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

H.R. 435, legislation to terminate the NFIP by 2013, has been introduced by Rep. Miller of Michigan. 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 insurance demand more efficiently than the federal government can. However, the NFIP was created in the first place because the private market failed. 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.

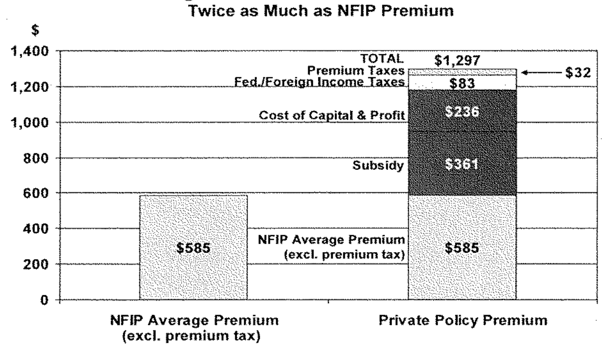
This existence of this market failure is supported by the market research of RAND[2] and the General Accountability Office (GAO).[3] These studies find limited-to-no private market potential, as there are no governmental or other barriers to prevent private insurers from entering the flood insurance 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 3000% 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.

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.

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 – costs 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, 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 $110 to $683 dollars to the average, depending on flood zone. The additional taxes would add from $39 to $239. 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 $15 to $92. In total, the average premium would more than double to approximately $1,300 from $600 according to the PCI's estimates.

Figure 1
Average Private Flood Premium is More Than 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 the wealthiest) could afford flood insurance at more than double the average rate. Already fewer 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 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

4 Property Casualty Insurers Association, "True Market-Risk Rates for Flood Insurance," March 7, 2011.

would not decline; 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 self-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 and financial assistance.

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

In 2008, a GAO study of NFIP rates was supplemented by a state-by-state analysis which summed claim payments and premiums from 1978 to 2007 and then subtracted total premiums from total claims.[5] Because this supplemental analysis also showed that some coastal states were receiving more in claims than they paid in premiums over 30 years, others concluded that losses in these states must have been offset by the premiums paid in non-coastal states. The argument is one of fairness that non-coastal states are being forced to pay into a program from which they are getting relatively little in return. One 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 an interpretation of a partial analysis that was not designed for that purpose. Rather, the GAO was looking for a pattern among states with "high-loss" years (i.e., years when a state's annual claims exceeded its premiums). 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 GAO explicitly acknowledged the limitations of relying on this partial analysis to draw conclusions about whether states are paying their fair share of the flood risk:

> "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." [6]

While the GAO did adjust for inflation, the analysis did not account for whether high-loss years corresponded with high-premium years. FEMA data shows that in the early 1980s, Michigan, for example, had several high-loss years in a row: in 1980, 1981, 1982, 1985, and again in 1986, the state's claims exceeded its premiums. This was around a time when Michigan had approximately half the policies it does today (13,000 on average from 1980-86 vs. nearly 26,000 in 2009). Were Michigan to experience a similar amount of claim payments today, the risk would be spread out over a larger number of insured properties distributed over a wider geographical area. A 30-year total would not provide a complete picture of this. It would not show which states are less (or more) exposed to flood risk today versus yesterday.

The GAO analysis ranked 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

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

6 Ibid., Page 25.

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.

Also 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."[7]

By not including the NFIP's administrative expenses in the calculus, any surplus (when the 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) and 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.

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	

7 Ibid., p. 24.

While the number of high-loss years provides 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."[8] These states contribute way more than others to the NFIP's overall capacity to offset flood losses nationwide in a given year. RAND had already estimated that although the NFIP's participation rates in flood zones exceed 60% in the South and West, they are closer to 20% in the Midwest and Northeast.[9] In a separate report,[10] 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 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 losses are distributed fairly evenly across United States. Using the number of presidential flood disaster declarations from 1990 to 2005 as a proxy, the GAO color-coded a map

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8 Ibid., page 25.

9 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.

10 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).

of the United States (appended to this testimony).[11] This map reveals that areas in orange (where there were 6-10 declarations) pervaded every region of the country except Mountain States. However, a large percentage of these mountainous areas have been designated public lands so flooding may have occurred there, just not in a populated area or not yet at a magnitude to prompt a major declaration. If, alternatively, one considers 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 areas (designated "V zones"), the number of policies represented less than 2% of all NFIP policies in force from 1997 to 2006.[12]

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. 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.[13]

In summary, while some may believe there is a cross subsidy from non-coastal to coastal states based on one interpretation of what the authors consider a partial and inconclusive analysis of the NFIP, the weight of data does not support the conclusion. Analyses of the number of high-loss

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11 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.

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

13 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.]

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.

Recent reports have called attention to the NFIP's debt and repeated pay-outs for some properties (e.g., see USA Today, "Huge Losses Put Federal Flood Insurance Plan in Red" (August 26, 2010)). 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 (0) 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 paid back the loan in full with interest.[14] Such borrowing does not translate into higher taxes. For use of the funds that would otherwise be freed up for other uses, the Treasury charges interest at a current annual rate of 0.25%. Once the NFIP pays off a loan, taxpayers 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.

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

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.[15] 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."

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

Before the Subcommittee is a discussion draft of legislation titled the "The Flood Insurance Reform Act of 2011." NAR strongly supports the provision to reauthorize the NFIP for a full five years, ending the current stopgap approach that has led to nine extensions and five lapses of program authority since 2008. Two of these lapses immeasurably undermined real estate investor confidence. In June 2010 alone, one lapse resulted in the delay or cancellation of 47,000 home sales according to NAR survey data. While we do have concerns with some of the draft's reforms, we support the Subcommittee's overall approach to reauthorize the program long-term before current authority expires on September 30 of this year and share the goal of strengthening the long-term viability of this critical program. Below we provide a description of each section of the draft followed by NAR's comments.

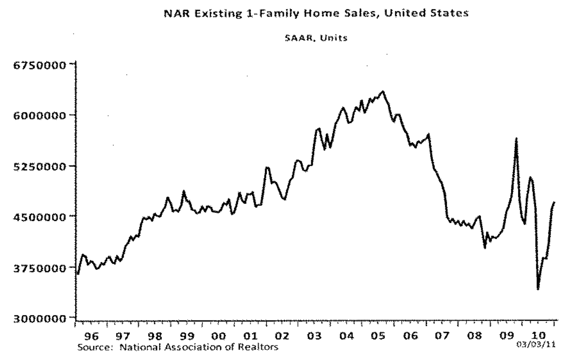
<u>Section 2: Extensions.</u>

This provision would reauthorize the NFIP through September 30, 2016.

NAR Comments: We strongly support this provision. We believe that a reauthorization for a minimum of 5 years would provide needed certainty for real estate markets to recover.

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

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.

<u>Section 3: Mandatory Purchase.</u>

These provisions would authorize FEMA to suspend for 12 months (and extend for up to two more 12-month periods) the federal mandate to purchase flood insurance in communities that are newly included in the 100-year floodplain. To be eligible, these communities must be:

- In an area where there has been no history of flooding;
- In the process of appealing a new floodplain map (where the insurance is required); or

- Making progress toward improving a flood protection system, such as a levee or dam.

While during a delay, the federal mandate would not apply, the language explicitly provides the lender or servicer discretion to itself require flood insurance to obtain a loan. It would also terminate and refund "force placed" insurance (i.e., insurance that is bought and placed by the lender and imposed on the borrower to pay).

NAR Comments: It is reasonable to delay the flood insurance mandate while the communities work through appeals over either the accuracy of new floodplain maps or the re-designation of areas as a 100- year floodplain while the community is still improving a system that protects those areas from a 100-year flood. However, we question whether this section would effectively establish a moratorium for the purchase of flood insurance for most property owners in areas newly covered by flood maps, because lenders may still require it as a condition of the loan. Lenders are likely to insist on protecting the security for the loan by either requiring the homeowner to purchase flood insurance, or even if this is prohibited by law, by refusing to make loans for properties in newly designated floodplains. Further, if a lender seeks to securitize a mortgage by selling it to an issuer of a mortgage-backed security, flood insurance would likely be required in order to make the security marketable to investors.

We would urge the Subcommittee to streamline the flood mapping appeals process for obtaining a letter of map amendment or revision. Currently, individual property owners may face significant transaction costs in coordinating appeals across many properties. Communities may also appeal but that would 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 to the property owners or communities that have been incorrectly drawn into the 100-year floodplain.

<u>Section 4: Reforms of Coverage Terms.</u>

These provisions would:

- Set a minimum annual deductible both for properties paying a subsidized premium rate and those paying the full risk (actuarial) rate;
- Index coverage limits annually based on the previous year's inflation beginning in 2012;
- Provide optional coverage for loss of use of the residence or business interruption at the full-risk rate if there is not a market for the coverage and it will not lead to additional borrowing; and
- Provide for residential rate increases/fees to be paid in quarterly installments.

NAR Comments: We support provisions to index or expand coverage to encourage participation in the NFIP. Increasing participation 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. Adding options for living expenses, basement improvements, and the replacement cost of contents would also help increase protection for home- and small-business owners. Increasing the coverage limits, which have not been adjusted despite inflation since 1994, would more accurately reflect increases in property and contents values and provide fuller coverage to policyholders. Setting minimum deductibles to improve the long-term solvency of the financial program is reasonable. Allowing residents to pay in installments could help with the affordability of rate increase under the NFIP.

Section 5. Reforms of Premium Rates.

These provisions would:

- Authorize an annual premium increase of up to a maximum of 20% per year.
- Phase-in the full-risk rate for properties newly mapped into the 100 year floodplain. The rate would increase by 50% in the initial year and by 20% each year thereafter until the full-risk rate is reached.
- Phases-in the full rate (by 20% a year until the full-risk rate is achieved) for the following categories of subsidized property:
    - Non-residential Properties;
    - Non-primary Residences (includes multi-family);
    - Primary Residences at Sale;
    - Homes Substantially Damaged or Improved; and
    - Homes with Multiple Claims.
- Prohibits extension of subsidized rates for lapsed NFIP policies.

NAR Comments: We would support increasing to the full risk (actuarial) rate properties that have a demonstrated history of flood loss. In particular, the repetitive loss properties (addressed under "homes with multiple claims") have been estimated to account for 1% of NFIP properties but 30% of claims. In addition, we would also encourage the Subcommittee to strengthen the Severe Repetitive Loss program to ensure such properties are mitigated or subject to rate increases that reflects its loss history.

However, we would have concerns with applying these provisions to the older properties where there has been no flood or loss. These properties were charged a less-than-full premium rate because they were built before the flood risk was mapped or known. At the time these properties were built, there were not the NFIP standards to which they could build. Congress believed it was better to encourage these owners to participate in the NFIP under the lesser rate and mitigate or strengthen their properties against flood risk so that the taxpayers would not have to pay for the future damage through disaster assistance payments. Under the draft bill, the owners of these properties, who may have been contributing premium dollars to the NFIP for decades, would now have to pay significantly more, not because there has been a flood or loss or even a change in their flood risk. Instead, they are being asked to pay more because ownership of the property has changed (through sale of a primary residence) or the property is not the owner's primary residence (i.e., it's a non-primary residence or non-residential property).

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.

We have concerns about the affordability of these provisions and respectfully request that the Subcommittee reconsider applying them to older properties without a demonstrated loss. At a minimum, any provisions should:

1) Spread out any rate increases evenly over the entire base over time so that everyone has ample opportunity to adjust to the increases and no one has to shoulder the entire increase in a single year. For example, the discussion draft would gradually phase-in the rate over at least a five-year period that would not begin until one year after the date of enactment. 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.
2) Ensure that the primary residences receive the same phase-in flexibility as the other older properties. Currently, there appears to be a technical error in the draft bill. Under Sec. 5(c)(3), annual rate increases are tied to a fixed date – i.e., they would begin at "the expiration of the 12 month period that begins on the effective date of the Act" and increase by a maximum of 20% per year until the full-risk rate is achieved. However, if a primary residence is sold after the full rate has been achieved, the owner would not benefit from the phase-in; the rate would more than double overnight. Any such residence sold after the phase-in begins but before the full rate is achieved, would see a less gradual increase than those properties sold prior to the phase-in. NAR strongly urges the Subcommittee to correct this technical drafting error by tying the phase-in for primary residences to the point of sale, not the bill's effective date.
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 residential and commercial properties, including multifamily housing, non-primary residential and commercial properties.
5) 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. A similar study was included in the House passed bill.

Section 6: Technical Mapping Advisory Council.

This section establishes a Technical Mapping Advisory Council to propose new standards for more accurate flood maps. It would include a real estate expert on the Council.

NAR Comments: We support efforts to improve the accuracy of floodplain maps. We believe that to effectively meet its charge, the Council must include a real estate expert as a member.

Section 7: FEMA Incorporation of New Mapping Protocols.

These provisions require FEMA to:

- Implement the standards and update the maps within 5 years subject to appropriations.
- Report to Congress if it does not implement all the Council recommendations.
- Ensure that floodplain mapping delineates not only the 100-year floodplain but also:
    - The 250-year floodplain;
    - Areas of residual risk (behind levees, dams or other man-made structures); and
    - Areas "subject to graduated and other risk levels, to the max extent possible."

NAR Comments: Bill provisions to improve the accuracy of flood maps imply that at least some of the 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 250-year floodplain, residual- and other-risk areas.

Section 8: Privatization Initiatives.

This section would:

- Require FEMA and the GAO to report to Congress with recommendations on privatizing the NFIP.
- Authorize FEMA to carry out "Private Risk-Management Initiatives" to "determine the capacity of private insurers, reinsurers, and financial markets to assist communities, on a voluntary basis only, in managing the full range of financial risks associated with flooding."

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 Subcommittee to strike this section.

Section 9: FEMA Annual Report on Insurance Program.

NAR comments: None.

Section 10: Technical Corrections.

NAR comments: None.

Section 11: Community Building Code Administration Grants.

NAR Comments: Expanding grant authority to strengthen properties against flood loss is reasonable.

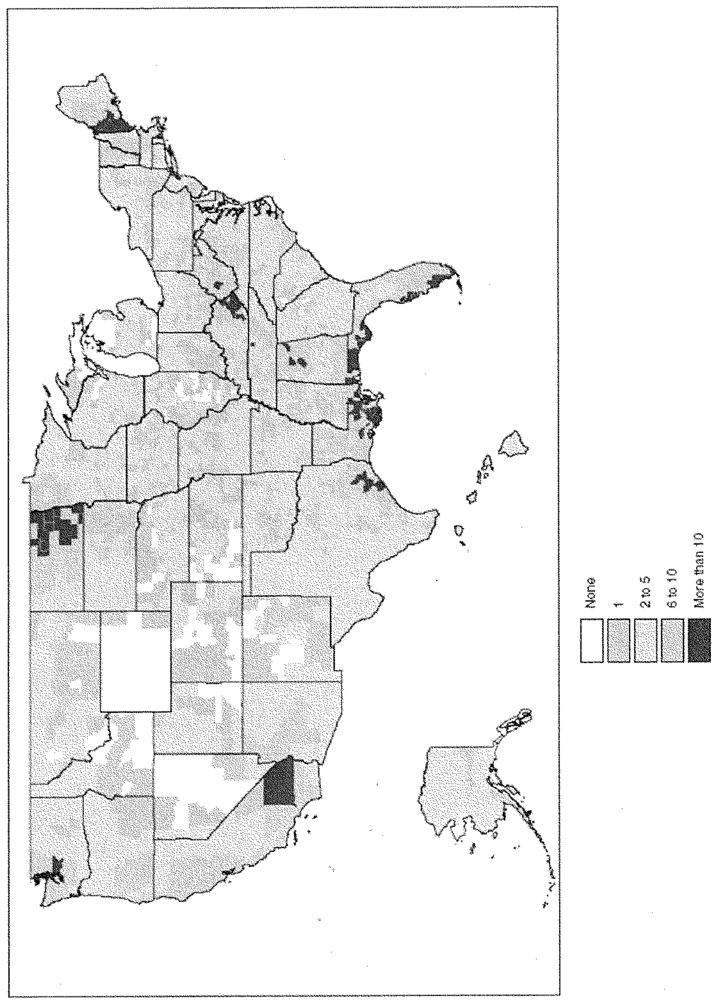
Conclusion

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 Subcommittee is considering a bill that makes difficult reform choices, it 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 Subcommittee 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



Allstate.
You're in good hands.

Dean T. Pappas
Vice President and Asst. General Counsel
Federal Legislative and Regulatory Affairs

Chairman Judy Biggert
U.S. House of Representatives
House Financial Services Committee
Subcommittee on Insurance, Housing, & Community Opportunity
2113 Rayburn House Office Building
Washington, DC 20515

Chairman Biggert,

I am writing on behalf of Allstate Insurance Company to express our strong support for the prompt reauthorization of the National Flood Insurance Program (NFIP) and efforts to strengthen it. Allstate has supported and participated in the NFIP as a Write Your Own carrier for many years and believes it is an essential component of our nation's catastrophe protection infrastructure.

We commend the Subcommittee on Insurance, Housing and Community Opportunity, Chairwoman Biggert and Ranking Member Gutierrez for holding a hearing this week to begin the process of reauthorization and to explore reform of NFIP. We also commend Chairwoman Biggert for issuing the discussion draft of the Flood Insurance Reform Act of 2011 which would make many important improvements to the program. We support the bill because it would effect long-term reauthorization and improvement of the program to ensure NFIP's continued viability and the continued protection of homeowners across the United States.

Most importantly, Chairwoman Biggert's five-year reauthorization of NFIP would bring much-needed stability to the flood insurance program. Recent lapses have disrupted the program, placed housing purchases in jeopardy, left customers with uncertain coverage and adversely impacted the ability of Write Your Own carriers to effectively serve customers with NFIP policies. Rather than serve as a lever to produce reform, the repeated need to focus on short-term reauthorizations has prevented Congress from effectively working on important reforms to the program. We respectfully urge both the Subcommittee and the full Financial Services Committee to immediately move the legislative process along so that all of the other steps in the process of reauthorization and reform can be completed well before the next expiration date of September 30th draws near.

In addition to providing the long-term stability needed in the program, the draft legislation includes provisions that will financially strengthen the program and better protect policyholders. Although the current NFIP debt resulted almost entirely from levee failures following Hurricane Katrina, NFIP must move away from the built-in subsidies that make the program actuarially unsound. In particular, we support:

- The gradual phase-out of subsidies for repetitive loss properties, second homes and grandfathered properties that are sold to new owners;
- Indexing coverage limits to inflation so the program provides coverage that reflects current economic realities; and
- Expanded living expense and business interruption coverages, which will also enhance program participation and effectiveness.

Consistent with the spirit of circulating a discussion draft, we note that there are other reforms that would further improve the NFIP. To limit adverse selection and better spread risk, options to expand the mandatory purchase requirement should be examined. There is a perception held by many in the public that post-event government disaster relief will make up for a lack of insurance, and this perception discour-

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ages people from purchasing flood coverage. In addition, companies participating in the Write Your Own program need additional clarification that federal law and federal courts will determine the standards applied to the NFIP. The public-private partnership of the WYO program will only thrive if participating carriers can effectively look to FEMA for direction and confidently rely on that direction.

Finally, the bill calls for further study of potential privatization options for the flood program. We support and encourage that exploration, and look forward to assisting with it. We believe our nation needs a comprehensive, integrated solution to deal more effectively and efficiently with natural catastrophe. A key part of the solution lies in strengthening America's financial infrastructure and beginning to build a financial backstop, leveraging both the public and private sectors to increase capacity and provide stability.

In conclusion, we believe that this bill and the efforts of this committee offer an outstanding opportunity to effectively reform and renew a program that has helped countless communities and Americans recover from catastrophe.

Sincerely,

Dean T. Pappas

INTERNATIONAL CODE COUNCIL

International Code Council
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March 11, 2011

Chairman Judy Biggert
Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives
2113 Rayburn HOB
Washington, DC 20515

Dear Chairman Biggert:

I write to express the strong support of the International Code Council for your proposed amendment to the Housing and Community Development Act of 1974 at Sec. 11 of the discussion draft of the National Flood Insurance Program re-authorization legislation.

You understand the key role that strong local building departments play in mitigating the damage that results from floods and other natural disasters. Unfortunately, in the depressed construction market of the last few years, building departments across the nation have been cut back, as local governments have been affected by reduced tax and fee revenues. But even in difficult times, the need for strong building code compliance remains. Citizens benefit, when their homes, and the places they work, play and worship, are safe and structurally sound, and able to withstand the effects of weather and natural disasters.

You demonstrated your leadership in sponsoring legislation in the past Congress that would allow local jurisdictions to match Federal funds to support strong code compliance. That legislation, that would have established a new program for community building code grants, was a good idea. The new proposal, to include the community building code support as a defined and eligible recipient of Community Block Grant Funding, is a sensible and common sense approach to address this issue. The proposed section 11 specifically recognizes the critical nature of a well-trained and equipped building department, while still allowing the local jurisdiction to determine how best to allocate block grant funds. It uses an existing program, and makes clear that local governments can use their grants to improve building code compliance

On behalf of the more than 50,000 building and fire code officials in the United States, we strongly support this provision and ask that the Subcommittee support including this key language in the National Flood Insurance Program authorization extension.

Sincerely,

Richard P. Weiland
Chief executive Officer

LLOYD'S

The Honorable Judy Biggert
Chairwoman
Subcommittee on Insurance, Housing
and Community Opportunity
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Luis Gutierrez
Ranking Member
Subcommittee on Insurance, Housing
and Community Opportunity
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

11 March 2011

Dear Chairwoman Biggert and Ranking Member Gutierrez:

Legislative Proposals to Reform the National Flood Insurance Program

Lloyd's notes with interest the Subcommittee's hearing to examine the future shape of the National Flood Insurance Program (NFIP). Lloyd's is a significant player in both the surplus lines and reinsurance markets in the United States, playing an important role in providing a measure of economic stability to millions of Americans in the face of natural catastrophes. Lloyd's also provides reinsurance support to state-sponsored catastrophe insurance providers.

Lloyd's has seen numerous approaches globally to insuring flood risk, and has found that the financial problems of providing protection can be just as complex as the physical problems. There are instances worldwide where both government and private initiatives are used to good effect in solving problems of insurability and affordability.

Lloyd's encourages the Subcommittee, in the course of its deliberations, to look at the NFIP's future in the context of a healthy insurance industry's ability to provide capacity. Central to this is a consideration of actuarially-sound pricing that insurers need to be able to justify deploying capital. We believe it may be instructive for the Subcommittee to look at the ways in which other countries have approached flood protection and to consider whether and how the private insurance market plays a role in such approaches. In that light, we are encouraged to see that the proposed bill for discussion encourages FEMA and the GAO to consider options for private industry involvement. Finally, we encourage the Subcommittee to consider those parts of the current flood insurance market arrangements that work well and can be retained under a reformed NFIP.

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Reform of the NFIP is needed. However, Lloyd's understands that the task of making this real is a complex and difficult one. We therefore stand ready to assist in those efforts as needed.

Respectfully submitted,

Sean McGovern
Director & General Counsel
Lloyd's of London

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

National Apartment Association

March 11, 2011

Honorable Judy Biggert
Chairwoman
Subcommittee on Insurance, Housing,
and Community Opportunity
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Honorable Luis Gutierrez
Ranking Member
Subcommittee on Insurance, Housing,
and Community Opportunity
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Chairman Biggert and Ranking Member Guttierez:

On behalf of the National Multi Housing Council (NMHC) and the National Apartment Association (NAA), we commend your leadership efforts to address the future of the National Flood Insurance Program (NFIP). We also thank you for the opportunity to offer our thoughts regarding the discussion draft of the Flood Insurance Reform Act of 2011.

NMHC and NAA represent the nation's leading apartment firms. Our combined memberships are engaged in all aspects of the industry, including ownership, development, management and finance. NMHC represents the principal officers of the industry's largest and most prominent firms. NAA is the largest national federation of state and local apartment associations with 170 state and local affiliates comprised of more than 50,000 members. Together we represent approximately six million apartment homes.

The future stability of the property insurance market and its ability to withstand the continued occurrence of catastrophic events remains a top concern to our industry. With floods being the most common natural disaster experienced in the U.S., the NFIP provides flood coverage that is available and affordable at all times. Established in 1968 to offer affordable insurance that the private market was not willing to offer, the NFIP reduces taxpayer-funded disaster assistance when flooding strikes. Our members rely on this critical program to not only protect their property investment but to help manage the increasing costs of providing housing.

We largely support the provisions of the draft legislation as indicated below and also offer our views on that which we seek clarification. Specifically:

- **Long-Term Authorization** - The NFIP has been operating on a series of short-term extensions since 2008, creating a level of uncertainty for property owners and managers who rely on this program for coverage. The inability to issue new policies, renew existing policies, change limits or pay claims are the negative consequences associated with short-term extensions. We strongly support the 5-year reauthorization as provided for in the bill.

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- **Indexing of Maximum Limits** - The NFIP has not kept pace with inflation and, therefore, we welcome the annual adjustment of coverage limits. It recognizes that the current limits are outdated and do not reflect increased real estate values.

- **Business Interruption Coverage** - If stated conditions are met, allowing the program to offer additional coverage for loss of business due to a flood loss will permit a property owner to more quickly recover from an event. Property owners frequently purchase this line of coverage when property damage forces the relocation of business operations, resident relocations, and other expenses and we, therefore, support this addition.

- **5-Year Phase in of Flood Insurance Rates for Newly Mapped Areas** - Properties newly mapped into an area not previously designated as having special flood hazards can be financially challenged when faced with a new and unanticipated operating cost. Therefore, a phase-in of such costs is a reasonable program change.

- **Phase-In of Actuarial Rates for Certain Properties** - The draft proposal does not specify multifamily properties in this provision. However, under the NFIP, multifamily units are defined as residential properties. Therefore, absent clarification in the following provision, we are concerned that apartment properties will be inappropriately interpreted in this category.

  > ***Section 5(c)(3)*** *Second Homes and Vacation Homes - Any residential property that is not the primary residence of any individual*

  Rental apartments serve as the primary residences for 1/3 of Americans today. We estimate that the majority of apartment properties eligible for the subsidized rates are older and most likely serve the affordable market. Such a change would make this housing more expensive to operate and can result in increased rents at a time when there is a critical shortage of affordable housing. We, therefore, seek clarification to exempt multifamily properties from this provision.

- **Authority to Temporarily Suspend Mandatory Purchase Requirement** - It has not been uncommon for apartment owners to have their properties misclassified as being in high-risk flood zones, or Special Flood Hazard Areas (SFHA). Therefore, it seems reasonable to suspend the mandatory purchase requirement for properties in communities newly designated in the 100-year floodplain. However, it is unclear how this suspension would benefit property owners who otherwise must comply with lender requirements. We, therefore, suggest pursuing efforts that might improve the appeals process to mitigate unnecessary costs and resources.

We thank you for the opportunity to present the views of the multifamily industry as you begin deliberations to reform the NFIP. The NFIP serves an important purpose and is a valued and necessary risk management tool for apartment owners and managers. We stand ready to support the efforts of Congress to make the necessary improvements to the program to ensure its long-term success.

Sincerely,

Douglas M. Bibby
President
National Multi Housing Council

Douglas S. Culkin, CAE
President
National Apartment Association

Cc: Subcommittee Members

DATA METRICS NEEDED FROM FEMA FOR PRIVATE SECTOR TO ANALIZE RISK

The Reinsurance Association of America and other reinsurer interests have advanced proposals to reduce the National Flood Insurance Program's reliance on taxpayers and Federal debt (currently standing at $17.75 billion) through the use of private market reinsurance and catastrophe bond capacity from the capital markets. Similar to the practice with the placement of reinsurance for private insurers and state insurance programs, reinsurers and brokers, working with NFIP officials, first would develop a proposed approach for placing such a property catastrophe program before offering it to the market for bids.

In order for reinsurers and capital markets participants to assess options for the National Flood Insurance Program to transfer insured risk from the Federal government and taxpayers to the reinsurance and capital markets, it would be necessary for data related to the NFIP to be provided to interested parties for analysis. This would allow the markets to advise how best to proceed in order for such a placement to be structured and ultimately successful.

There are several precedents of other government entities similar to the NFIP releasing policy level data to complete an insurance/reinsurance transaction with appropriate Non-Disclosure Agreements signed between the parties to protect the policyholder data. Examples of these are state wind pools and the California Earthquake Authority (CEA) that purchase reinsurance or securitize their risk through bond placements. Those transactions are completed using location level information to analyze the potential risk in the transaction. Before that data is provided to the markets, proper Non Disclosure Agreements are signed and specific information on policyholder name and premium removed.

The key data elements that modelers, underwriters and brokers traditionally analyze in order to complete a reinsurance transaction for a property catastrophe program for an insurer or state property program are summarized below in order of priority. It is understood that this level of detail may not be available from the NFIP, but it constitutes a basis for discussions about the level of detail that could be made available through the NFIP from its own data sources or WYO companies that collect data for NFIP insured properties.

1) Value of property by coverage – the catastrophe model damage estimation process starts with the value of the structure and then overlays insurance terms
2) Insured limit of property by coverage – at or below NFIP maximum insured limit (building and contents distinguished)
3) Applied deductibles
4) Street address of the location to determine the hazard - street number, street name, city, zip code, state
5) Number of stories and basement if any-- to differentiate single story vs high rise damage potential
6) Line of business – Homeowners , commercial or commercial residential (such as apartment buildings and condominiums)
7) Occupancy Type - Single Family Home, Hotel, etc.
8) Construction Type - Wood, Masonry, Steel, etc.
9) Flood Zone – to validate geocode and insure the risk is in the appropriate flood zone for risk assessment
10) Site specific mitigation (elevation of the structure or levee, for example) – if not site specific, local mitigation related to the structure

While this level of detail would improve the analysis and recommendation about how to structure a property catastrophe program, some of this information could be aggregated rather than provided in detail.

NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

Local Agents Serving Main Street America℠

March 10, 2011

The Honorable Judy Biggert
Chairman
Subcommittee on Insurance, Housing, and Community Opportunity
House Committee on Financial Services
U.S. House of Representatives

Dear Chairman Biggert,

On behalf of the National Association of Professional Insurance Agents (PIA) and our independent insurance agency owners, we thank you for addressing the necessary reforms to the National Flood Insurance Program (NFIP) in your discussion draft. We are highly encouraged by the draft reauthorization language and are willing to help move the necessary reforms forward.

PIA has a long history of supporting the National Flood Insurance Program (NFIP) and supports comprehensive reforms to make the program more sustainable. The program offers critical service to those affected by flooding events and provides the necessary coverage that the private market has been almost entirely unwilling to insure. The NFIP remains virtually the only way for homeowners and businesses to insure themselves against the catastrophic nature of floods.

Independent insurance agents play a vital role in delivering the program to consumers. They are the face of the program, interacting with the policyholders and offer unique perspective to the challenges that the program faces. Because of this, the complexities of the program, which are far greater than most lines of insurance, greatly affect insurance agents. Making the program more efficient, sound, and stable would allow for greater success moving forward.

We strongly support a 5 year reauthorization of the program as noted in the draft bill. This is something PIA has long supported and advocated for. An important key to the future of the NFIP is instilling confidence in the availability of the program. Current and future policyholders need assurance that the program will be there when they need it. Any air of uncertainty in the future of the program triggers additional legal obligations on insurance agents concerning notices to current NFIP policyholders about any pending lapse. A long-term reauthorization will provide stability and allow insurance agents to continue to deliver the dependable coverage that so many Americans rely on.

Additionally, PIA supports actuarially justified rates, which this bill addresses. Policies should be priced according to risk which will discourage building in high risk, environmentally sensitive areas. Risk based rates will provide more solvency to the program and reduce the exposure to taxpayers.

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NATIONAL ASSOCIATION OF
PROFESSIONAL INSURANCE AGENTS

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America℠

An important component for a strong, viable NFIP is offering appropriate coverage to policyholders. This draft bill allows for market-based increases on maximum coverage limits. Insurance agents have a responsibility to their customers to make certain that they are properly insured and this will assist them in doing so.

In addition to increasing coverage limits, commercial policyholders need the proper coverage to ensure successful recovery from a flooding event. The private market currently offers business interruption insurance (BII), though it is generally very expensive making it difficult for small-midsized companies to purchase. Usually, BII will cover lost profits, operating expenses, and sometimes expenses occurred from operating out of a temporary location while the original property is being repaired. A business with proper flood insurance could still be prone to insolvency following a catastrophic event without BII. The addition of BII to the NFIP reauthorization is a critical component that PIA strongly supports.

Lastly, PIA is pleased that this reform bill does not include the addition of further perils. PIA feels strongly that a major detriment to the NFIP would be the inclusion of wind coverage. Currently, only flood insurance is provided by the NFIP, while wind insurance is covered under many homeowners' insurance policies and statewide wind pools. PIA believes that combining the two perils in the NFIP would create more problems than solutions. The NFIP is currently over $18 billion in debt and is in no shape to take on additional perils. Expanding the program would only incentive development in areas that are prone to wind and water storms and would create a false sense of security to those who live there.

As the committee continues holding hearings and we continue to review legislative proposals, we remain ready and willing to work with you to implement the necessary reforms to make the NFIP stronger. Please do not hesitate to contact us for additional information.

Sincerely,

Leonard C. Brevik
CEO & EVP
PIA National

Mike Becker
Director, Federal Affairs
PIA National

American Insurance Association

STATEMENT OF
THE AMERICAN INSURANCE ASSOCIATION

"LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM"

SUBCOMMITTEE ON INSURANCE, HOUSING & COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES
MARCH 11, 2011

The American Insurance Association (AIA) is pleased to submit this statement as the subcommittee considers legislative proposals to reform the National Flood Insurance Program (NFIP).

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 more than $117 billion annually in premiums. AIA and several of our 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. Overall, AIA views the Flood Insurance Reform Act of 2011 discussion draft as a positive contribution to the ongoing reform discussion in Congress.

BACKGROUND

The NFIP has experienced repeated short-term extensions leading up to this hearing, 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, real-estate professionals and lenders. AIA, its members and, indeed, all "Write-Your-Own" insurers believe that a long-term extension, combined with essential reforms, is needed to bring stability and certainty to the program.

Since the hurricanes of 2004 and 2005, a cornerstone of AIA's pro-active 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.

We are pleased that several important AIA recommendations for reform are included in the Committee's discussion draft. Specifically, the draft contains (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).

EXAMINATION OF DISCUSSION DRAFT

1. 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 the five-year extension contained in the discussion draft, 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.

2. 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. Among possible solutions to address the needs of those who cannot afford true risk-based premium payments 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.

The discussion draft takes a variety of positive steps toward better pricing NFIP coverage. It would increase the permissible annual premium (so called "elasticity band") from 10 percent to 20 percent. It would phase in 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—on the basis of 20 percent annual increases to move from the chargeable premium rate to the applicable estimated risk premium rate. These are all positive steps that move the program towards a better fiscal position.

3. Changes to Coverage

WYO insurers help administer 95 percent of the NFIP business providing private market 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, 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.

We are pleased that the discussion draft incorporates the suggestions listed above. Undertaking these steps will increase product diversification which should encourage more consumers to consider purchasing NFIP flood coverage.

4. FEMA and GAO Studies

While AIA is supportive of the discussion draft, there are other reform proposals being discussed that need close scrutiny. 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 National Flood Insurance Program was created precisely because the private homeowners insurance market could not write flood insurance on an economically feasible basis. 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. Indeed, long before the creation of the NFIP, private insurers had effectively stopped providing flood coverage.

The discussion draft proposes separate FEMA and GAO studies regarding the feasibility of privatization to be completed within 18 months of enactment. These studies are prudent first steps and we look forward to working with FEMA and GAO and reviewing their findings.

5. Some Concerns

While the discussion draft contains a number of positive proposals, we are left to ask why properties in newly designated special flood hazard areas (the "newly mapped") will receive preferential treatment? Not only will such properties receive the rate phase-in, they will have the ability to avoid mandatory purchase altogether if their community objects. These aspects of the discussion draft seem inconsistent with the needed movement toward price reflecting risk and greater financial security for the program.

CONCLUSION

Thank you for the opportunity to submit this statement. We believe the discussion draft makes significant progress towards protecting consumers and reforming and improving the National Flood Insurance Program. We look forward to working with the Committee as this process moves forward.

NATIONAL WILDLIFE FEDERATION

March 10, 2011

The Honorable Judy Biggert
Chairwoman, Subcommittee on Insurance, Housing and Community Opportunity
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Louis V. Gutierrez
Ranking Member, Subcommittee on Insurance, Housing and Community Opportunity
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Biggert and Ranking Member Gutierrez,

National Wildlife Federation (NWF), the nation's largest conservation education and advocacy organization with more than four million members and supporters and affiliates in 47 states and territories, has advocated for reforms to the National Flood Insurance Program (NFIP) for nearly two decades. We are pleased to see that you have made this a priority for the 112th Congress. We believe that the discussion draft of the Flood Insurance Reform Act of 2011 is a valuable first step to reforming the program. As you consider its merits and shortcomings, we appreciate the opportunity to comment on the discussion draft before the committee and to highlight the environmental implications of the program.

Overview of Environmental Concerns related to NFIP

The NFIP, which is administered by the Federal Emergency Management Agency (FEMA), was originally founded on a strategy developed by eminent scientists and government officials in the early 1960's 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. These strategies were designed to reduce risk, slow floodplain development and thereby better protect people and the environment.

Forty years later, we find major failures on each of these fronts, in large part because of failure to charge actuarially sound rates, the failure to aggressively mitigate risks, and the failure to protect the vital functions floodplains perform. National flood damages, particularly from major flooding events – rather than decreasing as the founders would have hoped – are now rising almost exponentially.

Floodplains represent some of the most vital wildlife habitat. They also are invaluable to the proper functioning of rivers, streams, coastal areas and other important aquatic resources. The development and destruction of these vital areas threaten wildlife and the people who live and work in these areas. The last several years have seen more and more devastating floods where lives and property have been lost or damaged.

The NFIP has failed to adequately restrict growth in high-risk flood prone and environmentally sensitive areas. Additionally, there is growing evidence that frequency and severity of major storms and hurricanes are increasing in many areas due in part to climate change and sea-level rise factors as well as land development patterns. Recent reports are showing accelerating glacial melting, which, in turn, is accelerating sea-level rise and increasing threats to coastal areas more rapidly than previously thought. Yet the NFIP has done little to anticipate the enormous potential for flood-related losses these changes portend. As such, we believe that climate change considerations must be central to the NFIP reform effort.

While originally well intentioned to be protective of floodplain areas, the NFIP has unfortunately become an unwarranted subsidy and enabler of floodplain development. The NFIP is intended to reduce the costs and vulnerabilities to flooding by identifying flood hazards, encouraging and requiring floodplain management and providing flood insurance at reasonable rates within communities that choose to participate in the program. Rather than discouraging development in vital floodplains, FEMA has implemented the NFIP in a manner that in many instances has increased flood risk to communities and is harming the natural resources and functions of floodplains and damaging important and necessary fish and wildlife habitat.

In reforming floodplain policies, we urge that Congress commit to a national hazard mitigation policy that emphasizes stronger standards, including rules that emphasize placing homes and businesses in areas away from flooding. Keeping development out of dangerous and environmentally-sensitive areas presents an effective, yet too often overlooked method of reducing flood losses.

As such, the NFIP should ensure that floodplain development no longer causes loss of critical floodplain functions, that the natural flood control functions of floodplains are restored, and that the vital habitat values of floodplains are protected. These changes can be assisted by actuarial pricing of insurance, increased hazard mitigation, strengthening the criteria for community eligibility and through accurate and updated mapping of floodplains. We appreciate that some of these concerns have been addressed in the first draft of the Flood Insurance Reform Act and look forward to collaborating with you to address more of these issues as the bill is considered by the Financial Services Committee. Following is a detailed explanation of key policy recommendations and how they could be addressed through legislation.

FEMA mapping must use the best available science to accurately reflect risk and place a priority on natural resources protection.

Mapping determines what areas and properties are subject to NFIP requirements. Currently, many FEMA maps are out-of-date, do not reflect the best available science or future flood risk resulting from land use and climate changes, do not identify important natural resource and habitat areas, and can be manipulated to allow for the removal of important areas from NFIP requirements in a manner that degrades or destroys natural resources. In order to protect floodplains, and minimize future flood events, the accuracy of these floodplain maps must be improved.

Foremost, floodplain maps must reflect the best available science regarding flood risk and natural resource protection by using accurate and current data, including science regarding climate change and other likely future conditions. Map revisions should make protection of listed species, habitat and natural resources a priority. FEMA's flood maps should also show a range of varying high risk areas up to the 500-year flood zone and "residual risk" areas that would be inundated due to levee or dam failure, and require appropriate land use and building codes to reduce risk and require properties in residual risk zones to have flood insurance. Additionally, map revisions that remove areas from flood insurance requirements due to placement of fill should be eliminated

The Flood Insurance Reform Act of 2011 begins to address these concerns. We support the creation of a Technical Mapping Advisory Council that includes representatives from the Natural Resources Conservation Service, Fish and Wildlife Service and NOAA and believe that creation and implementation of appropriate new mapping standards will better protect the environment.

Rates must reflect risk and provide incentive for floodplain and natural resource protection.

Currently, NFIP insurance rates do not reflect actual risk of flood damage and communities are not given adequate incentives to adopt policies that protect floodplains and the natural resources they provide. As a result, federal taxpayers are subsidizing development in dangerous and environmentally sensitive areas. As long as rates are not in line with risk, harmful development and environmental degradation will continue. The discussion draft Flood Insurance Reform Act makes some important changes through phasing out subsidies for certain classes of structures that have been especially costly. Some other costly subsidies remain, however, including many properties with repetitive losses. It is critical to reduce and eliminate subsidies that discourage owners from mitigating their own risk and to provide assistance to those who need it to mitigate their future risk, especially through buyouts or relocations of high-risk structures out of harm's way. It is also critical to remove these subsidies as quickly as possible and to limit the delay of mandatory purchase as much as possible.

NFIP community eligibility criteria must reduce flood risk to people and protect and restore natural resources.

The Flood Insurance Reform Act does not address 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 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. We believe 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. Repairs or improvements to existing structures must mitigate for damage to natural resources. All mitigation should prefer non-structural means and must account for the impacts of climate change. Voluntary buyouts of homes and businesses in high flood risk areas should be promoted with appropriate lands dedicated to open space uses. Communities should be required to strengthen land-use and building code standards and employ 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.

Climate change must be accounted for in any NFIP reform process.

While climate change must be a central consideration in all natural resource management decisions, floodplains will be particularly impacted by climate change. As such, NFIP reform must account for how climate change will place severe stresses upon riverine and coastal areas and as of yet, the Flood Insurance Reform Act does not address this important issue.

Climate change poses an unprecedented threat to our coastal and riverfront communities, where a large segment of our nation's population resides and a majority or our economic activity occurs. Sea level rise, strengthening of storms and floods, and other impacts of climate change are already being felt and are expected to intensify over the coming decades. This risk must be accounted for to ensure that the program protects people and the environment and that it effectively manages risk. Climate change concerns need to be a primary driver of NFIP's reform effort, or any changes will be inadequate to meet the challenges of the future.

The reality of climate change means that the number of devastating floods we have recently seen will only increase, with the result being greater harm to people, businesses, communities, wildlife, and natural resources. As you continue to debate this bill, we encourage the committee to ensure that climate change science guide all aspects of NFIP reform decisions, including eligibility criteria in determining whether community land use measures are adequately protective, mitigation required to account for floodplain impacts from development, mapping, evaluation of flood risks, and the determination of actuarial rates.

The discussion draft of the Flood Insurance Reform Act addresses some of NWF's key concerns and is an important step towards improving the program and better protecting property, people and the environment. While we have highlighted some areas for improvement, we applaud the first step towards reform and look forward to a continuing dialogue as the Financial Services Committee improves and passes the Flood Insurance Reform Act of 2011.

Written Statement of

Craig Fugate

Administrator

Federal Emergency Management Agency

FEMA

Legislative Proposals to Reform the National Flood Insurance Program

Before the
House Committee on Financial Services

Subcommittee on Insurance, Housing and Community Opportunity

Washington, DC

March 11, 2011

I. Introduction

Good afternoon 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: "[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.

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.

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

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.

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

quirements for issuance of a "Type A specific license of broad scope;" section 33.14 includes the requirements for issuance of a "Type B specific license of broad scope;" and section 33.15 includes the requirements for a "Type C specific license of broad scope." The NRC estimates that applicants number approximately 60 annually and that reporting time averages 32 hours for applications under section 33.13; 4 hours for applications under section 33.14; and one-half hour for applications under section 33.15.

NORMAN F. HEYL,
Regulatory Reports Review Officer.

[FR Doc.77-32601 Filed 11-9-77;8:45 am]

[4110-02]

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Office of Education

NATIONAL ADVISORY COUNCIL ON VOCATIONAL EDUCATION

Meeting

AGENCY: National Advisory Council on Vocational Education.

ACTION: Notice of public meeting.

SUMMARY: This notice sets forth the schedule and proposed agenda of forthcoming meetings of the National Advisory Council on Vocational Education. It also describes the functions of the Council. Notice of these meetings is required under the Federal Advisory Committee Act (5 U.S.C. Appendix 1, 10(a) (a) (a)). This document is intended to notify the general public of their opportunity to attend.

DATE: 8:30 a.m. to 4:30 p.m., December 5, 1977.

ADDRESS: Sheraton Seaside Hotel, Pennsylvania Avenue at the Boardwalk, Atlantic City, N. J.

FOR FURTHER INFORMATION CONTACT:

Virginia Solt, NACVE Staff, 425 13th Street NW., Suite 412, Washington, D.C. 20004, 202-376-8873.

The National Advisory Council on Vocational Education is established under Section 104 of the Vocational Education Amendments of 1968, Pub. L. 90-576. The Council is directed to:

(A) Advise the Commissioner concerning the administration of, preparation of general regulations for, and operation of, vocational education programs supported with assistance under this title;

(B) Review the administration and operation of vocational education programs under this title, including the effectiveness of such programs in meeting the purposes for which they are established and operated, make recommendations with respect thereto, and make annual reports of its findings and recommendations (including recommendations for changes in the provisions of this title) to the Secretary for transmittal to the Congress; and

(C) Conduct independent evaluations of programs carried out under this title and publish and distribute the results thereof.

The Meeting of the National Advisory Council on Vocational Education on December 5, 1977, will include the following agenda items:

(a.m.) Report of the Chairman.
Report of the Executive Director.
Approval of September Minutes.
Introduction of Guests.
Review of Budget Commitments.
Discussion of Other Council Reports and Business.
(p.m.) Continuation of Discussion of Other Council Reports and Business.

A Meeting of the Council Task Force on the Administration and Operation of the Bureau of Occupational and Adult Education of the U.S. Office of Education will take place at 1:30 p.m. on Saturday, December 3, 1977, in the St. Giles Room at the Resorts International West which is a part of the Chalfont Hadden Hotel.

Records shall be kept of all Council proceedings and shall be available fourteen days after the Meeting for public inspection at the Office of the National Advisory Council on Vocational Education located at 425 13th Street NW., Suite 412, Washington, D.C. 20004, under 5 U.S.C. 552(b).

Signed at Washington, D.C. on November 7, 1977.

REGINALD E. PETTY,
Executive Director, National Advisory Council on Vocational Education.

[FR Doc.77-32573 Filed 11-9-77;8:45 am]

[4110-12]

ADVISORY COUNCIL ON EDUCATION STATISTICS

Meeting

Notice is hereby given, pursuant to Pub. L. 92-463, that a meeting of the Advisory Council on Education Statistics will be held on December 7, 1977, from 9 a.m. to 4:30 p.m., in the conference room on the 6th floor, 200 Independence Avenue SW., Washington, D.C. 20201. The meeting will be continued on December 8, 1977, from 9 a.m. to 4:30 p.m. at the same location.

The Advisory Council on Education Statistics is mandated by section 406(c) of the General Education Provisions Act as added by section 501(a) of the Education Amendments of 1974, Pub. L. 93-380 (20 U.S.C. 1221e-1(c)), to advise the Secretary of the Department of Health, Education, and Welfare and the Assistant Secretary for Education, and the National Center for Education Statistics (NCES); and "shall review general policies for the operation of the Center and shall be responsible for establishing standards to ensure that statistics and analyses disseminated by the Center are of high quality and are not subject to political influence."

The meeting agenda will include a discussion of policies on the scope of NCES programs and services with particular emphasis on data acquisition and statistical services.

The meeting is open to the public; however, because of limited accommodations, those members of the public wishing to attend should make reservations by writing, no later than November 30, 1977, to:

Acting Executive Director, Advisory Council on Education Statistics, Room 3003, FOB-6, 400 Maryland Avenue SW., Washington, D.C. 20202.

Records shall be kept of all Council proceedings and shall be available for public inspection in the Office of the Administrator, National Center for Education Statistics, located at 400 Maryland Avenue SW., Washington, D.C. 20202.

Signed at Washington, D.C., on November 5, 1977.

MARIE D. ELDRIDGE,
Administrator, National Center for Education Statistics.

[FR Doc.77-32599 Filed 11-9-77;8:45 am]

[4210-01]

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Federal Insurance Administration

[Docket No. N-77-813]

NATIONAL FLOOD INSURANCE PROGRAM

Secretary's Report to the Congress Upon Making Determination To Operate Under Part B Framework

AGENCY: Housing and Urban Development-Federal Insurance Administration.

ACTION: Notice of report.

SUMMARY: The Secretary is publishing this report to the Congress after consultation with the Insurance Industry, and after determination that the Flood Insurance Program under the National Flood Insurance Act of 1968, would be assisted materially by the Federal Government's assumption, in whole or in part, of the operational responsibility for Flood Insurance. The report: (1) Sets forth reasons for this determination, (2) contains support for pertinent findings, (3) indicates to what extent utilization of the insurance industry is anticipated under the program, and (4) contains recommendations of the Secretary.

DETERMINATION DATE: The Secretary determined on November 2, 1977 that operation of the Flood Insurance Program would be assisted materially by Federal Government assumption, in whole or in part, of the operational responsibility for Flood Insurance.

FOR FURTHER INFORMATION CONTACT:

Ruth Prokop, General Counsel, Department of Housing and Urban Development, 451 7th Street SW., Washington, D.C. 20401, 202-755-7244.

SUPPLEMENTAL INFORMATION:

PART B—GOVERNMENT PROGRAM WITH INDUSTRY ASSISTANCE

DETERMINATION

After consultation with representatives of the insurance industry, I do hereby determine that operation of the flood insurance program authorized by the National Flood Insurance Act of 1968 would be assisted materially by the Federal Government's assumption, in whole or in part, of the operational responsibility for flood insurance.

NOVEMBER 2, 1977.

PATRICIA ROBERTS HARRIS,
Secretary, Department of Housing and Urban Development.

REPORT TO THE CONGRESS UPON MAKING DETERMINATION TO OPERATE THE NATIONAL FLOOD INSURANCE PROGRAM UNDER PART B FRAMEWORK

This report is submitted to the Congress pursuant to § 1340 of the National Flood Insurance Act of 1968 (Pub. L. 90-448; 42 U.S.C. § 4071), which requires the Secretary, after consultation with representatives of the insurance industry, and after making a determination that the operation of the flood insurance program under a Part A framework "cannot be carried out, or that such operation, in itself, would be assisted materially by the Federal Government's assumption, in whole or in part, of the operational responsibility for flood insurance * * *", to submit to Congress a report which "shall—

(1) State the reasons for such determination,

(2) Be supported by pertinent findings,

(3) Indicate the extent to which it is anticipated that the insurance industry will be utilized in providing flood insurance coverage under the program, and

(4) Contain such recommendations as the Secretary deemed advisable."

PROGRAM SUMMARY AND BACKGROUND

The flood insurance program, established by Congress in the National Flood Insurance Act of 1968 (the "Act"), is based on a dual principle—to make flood insurance available to homeowners and businessmen and to require that new construction in flood-prone areas be located and built so as to reduce the flood hazard and loss of life and property. In its implementation, the program represents a combined effort on the part of the Federal, State and local governments.

The Department of Housing and Urban Development (HUD), working closely with local governments, directs the development of the program which, in addition to providing insurance premium subsidies to substantially offset losses on properties in high risk areas and providing excess reinsurance to participating insurers, requires that local governments adopt and enforce flood plain management measures in order to avoid or reduce future flood damage to property and loss of lives in catastrophic floods.

The private insurance industry, represented by the National Flood Insurers Association (NFIA), a statutory pool of insurers with whom the Department has entered into a contract pursuant to Section 1332 of the Act (42 U.S.C. § 4052), provides a pledge of risk capital and through property agents and brokers sells and services the flood insurance policies. The NFIA also utilizes servicing companies, normally on a statewide basis, to disseminate information both to the public and to insurance agents, to process all insurance policies, and to handle the payment of flood losses in essentially the same manner as other types of insured property losses are adjusted.

Congress has entrusted the Secretary of the Department of Housing and Urban Development with very broad power and responsibility "to establish and carry out a national flood insurance program." (Section 1304(a) of the Act; 42 U.S.C. 4011(a)). The Secretary is specifically authorized to provide "for the general terms and conditions of insurability" and "the nature and limits of loss or damage * * * which may be covered by such insurance." (Section 1306(a) of the Act; 42 U.S.C. 4013). It is the Secretary who establishes premium rates for such insurance. (Sections 1307 and 1308 of the Act; 42 U.S.C. 4014 and 4015).

The Secretary has broad authority to arrange for the financing and administration of the flood insurance program and the method or methods by which claims for losses may be adjusted and paid. (Sections 1309-1312 of the Act; 42 U.S.C. 4016-4019). The Secretary is authorized to prescribe "appropriate requirements for insurance companies and other insurers" when they are permitted to participate in a pool to provide flood insurance coverage. (Section 1331 of the Act; 42 U.S.C. 4054). The Secretary is authorized to enter into such agreements with the pool as she deems necessary to carry out the purposes of the program. (Section 1332(a) of the Act; 42 U.S.C. 4052(a)).

The Secretary is authorized to utilize the facilities and services of insurance companies and other insurers, insurance agents, brokers or insurance adjustment organizations and other organizations "on such terms and conditions as may be agreed upon." (Section 1345 of the Act; 42 U.S.C. 4081).

The economic justification for the program (which requires extensive public subsidies to reduce premiums to the less than actuarially sound level acquired to permit general participation by those who are on the flood plain) is the reduction in the need for flood disaster relief appropriations through the reduction in loss which will result from prudent flood plain management and construction, and by the purchase of flood insurance by those in high hazard areas.

DEVELOPMENT OF THE ACT

In 1965, after several devastating hurricanes and after the National Association of Insurance Commissioners had failed to induce the insurance industry to adopt a voluntary State program of flood insurance, Congress directed the Department of Housing and Urban Development to undertake a study of various programs, including insurance programs, which might be established to help provide financial assistance to those suffering property losses in floods and other natural disasters. The Department's comprehensive study included a careful review of the flawed, and never implemented, Federal Flood Insurance Act of 1956 as well as an intensive examination of the most promising alternatives for providing assistance to flood victims.

On August 8, 1966, then Secretary of Housing and Urban Development, Robert C. Weaver forwarded to the President the Department's report on the study and its conclusions. The Secretary's transmittal letter stated: "the study concludes that flood insurance is both feasible and can promote the public interest." On August 12, 1966, President Johnson formally transmitted the Department's report to the Congress.

The report outlined four alternative methods of carrying out a national flood insurance program:

(1) A fully private and fully self-supporting flood insurance program, operated and managed wholly by private insurance companies.

(2) A program of flood insurance operated by the private insurance industry, with major help by the Federal government.

(3) A Federal flood insurance program operated by the private insurance industry as fiscal agents for the Federal government.

(4) An all-Federal program of flood insurance.

After reviewing all four alternatives, the report recommended the second alternative noting that: "A flood insurance program operated by the private insurance industry with extensive Federal help, seems both desirable and feasible; it would require each party to assume major responsibility."

In 1967, Congress considered a number of proposals for a flood insurance program and in 1968, it enacted a comprehensive blueprint for the establishment of such a program. The National Flood Insurance Act of 1968 contains detailed specifications for, among other things, the scope and priorities of the program, the nature and extent of insurance coverage to be made available, community flood plain management requirements to be met as a condition to community participation and insurance availability, program financing, and importantly, the organization and administration of the program.

As to the organization and administration of the program, the Act establishes the framework for the cooperative industry-government arrangement recommended in the 1966 report and authorizes the Secretary to implement the program in accordance with the framework which is designated in the statute as "Part A."

The Act also establishes a "Part B" framework which authorizes a Federally operated program which could be administered either with the assistance and services of private insurers or entirely by Federal employees. The Act authorizes the Secretary to shift from "Part A" to "Part B" after consultation with representatives of the insurance industry and notification to the Congress, once the Secretary has determined that "operation of the flood insurance program as provided under Part A cannot be carried out, or that such operation, in itself, would be assisted materially by the Federal Government's assumption, in whole or in part, of the operational responsibility for flood insurance * * *."

FOUNDING THE NATIONAL FLOOD INSURERS ASSOCIATION

The Act authorized the Secretary to encourage and to assist insurance companies to join together in a pool (1) to provide flood insurance coverage, (2) to participate financially in underwriting risks assumed based upon Secretary prescribed minimum requirements for capital or surplus or assets and (3) to adjust and pay claims for flood losses.

On June 6, 1969, the Department and the insurance industry, acting through the newly formed National Flood Insurers Association (NFIA), signed an agreement which established the relationship between the industry and the government and enabled the flood insurance program to be implemented under "Part A."

NFIA, which now consists of more than 130 private insurance companies representing a broad segment of the property and casualty insurance industry, including the nation's ten largest, was formed for the sole purpose of carrying out the National Flood Insurance Program. The Association is a voluntary nonprofit unincorporated association of insurers. Eligibility for participation requires $1,000,000 in assets, the assumption of at least $25,000 worth of underwriting loss to be incurred under all contracts of direct insurance or reinsurance arranged in the name of the Association in any one year, and the payment of $50 for each $25,000 pledged participation. In all matters, members are entitled to one vote for each $25,000 of pledged participation and as a result the ten largest private property and casualty insurers in the United States have effective control of the Executive Committee of the NFIA. It is significant, however, that despite the pledging of numerous units of $25,000 of risk these major companies are basically not at risk. The cost of any expense and flood insurance coverage is borne primarily by the insured property owners and the government. In fact, the "promised risk capital," is not paid in by the member insurers, and since 1969, when the program began, no participating insurer has expended any of its promised risk capital.

THE INITIAL PROGRAM

Despite the successful negotiation of the government-industry partnership in 1969, the new program foundered when it became apparent that the capacity to complete the basic flood hazard evaluations and rate studies necessary to qualify participating communities under the Act did not exist. In quick response to the problem, Congress, as part of the Housing and Urban Development Act of 1969 (P.L. 91–152; 42 U.S.C. 4056), amended the statute to authorize emergency implementation of the program for existing construction in communities where required studies were not yet completed.

Despite rapid implementation of the emergency program, however, community participation in, and coverage of flood-prone property under the program was disappointing. The program was voluntary and many communities did not join. Some communities chose to stay out rather than adopt required minimal flood plain management measures for identified special flood hazard areas within their jurisdictions; others did not join because of a lack of interest.

THE 1973 AMENDMENTS

In 1973, after another series of disastrous floods, notably those resulting from Hurricane Agnes, Congress passed the Flood Disaster Protection Act of 1973 (P.L. 93–234; 42 U.S.C. 4001 et seq.). This Act changed the basic nature of the program. It precluded direct Federal assistance for construction or acquisition purposes in identified special flood hazard areas of communities which were not participating in the program by the statutory deadline date, and required denial of any mortgage loan assistance from Federally supervised, approved, regulated, or insured lenders in those areas. In addition, it required the purchase of flood insurance as a condition to any Federally related mortgage loan in participating communities.

After enactment of the 1973 amendments, the program grew dramatically. As of January, 1973, more than four years after the program's inception, only 3,000 communities were participating in the program and only 200,000 property owners were insured. However, by October, 1977, the program had 16,000 participating communities, with over 1,400,000 policies outstanding.

The change from a voluntary to a mandatory program had an immediate and dramatic effect on the operations and workload of the NFIA. At the outset of the program and for a period of four years after its formation, the NFIA was a small organization without any significant professional staff. It relied on informal arrangements with the private insurance industry to obtain the services it required. As late as 1974, NFIA still relied almost exclusively on manual processing performed by various servicing entities.

INCREASED TENSION BETWEEN HUD AND NFIA

By March of 1974, the Department had become concerned with NFIA's management performance, the capacity of NFIA to handle the great workload demands generated by the changes in the flood insurance legislation and the willingness and ability of NFIA to provide certainty and uniformity in the treatment of policyholders. The Department, therefore, requested NFIA to develop a professional staff and to obtain data processing services essential to the efficient operation of the expanded program. In addition, since the agreement by the Government and NFIA could be terminated by NFIA at any time, the Department requested that such data processing services be performed by an independent company whose services the Department could acquire directly in the event of such a termination by NFIA.

Although change in the structure of NFIA came primarily in response to prodding by the Department, with the growth of a bureaucracy, the NFIA developed the capacity to identify and define substantial differences between it and the Department and to articulate an institutional position on significant policy issues.

For example, the Department, from the beginning of its relationship with NFIA, asserted the Secretary's authority to interpret the scope of coverage of the Standard Flood Insurance Policy. In the early years NFIA followed HUD interpretations in such matters as erosion and mudslide claims when disputes arose between insurers and policyholders. After 1974, however, NFIA asserted that it was not subject to HUD interpretations of flood insurance policy coverage.

For a period of time NFIA refused to comply with an interpretation that HUD issued in connection with NFIA's disclaimer of coverage for a policyholder's expense in removing insured personal property from insured premises in imminent danger from flood. HUD's interpretation was premised basically on the policy language which required the insured to "use every reasonable means to save and preserve the property at the time of and after an occurrence of * * * [flood]." NFIA refused to comply with the HUD interpretation and at the time of the flooding in Minot, N. Dak., announced throughout the affected area that removal costs would not be compensated under flood insurance policies.

NFIA also refused to competitively bid its servicer contracts. Rather, thirteen of the fifteen member companies which comprise the NFIA Executive Committee perform such servicing on a sole source basis receiving 81.1 percent of the program servicing fees. These fees amounted to a total of $16,056,418 in the period covering 1970–1975 for the thirteen largest participating insurers.

In addition, NFIA refused to accede to prior HUD approval of its overhead operating costs which increased dramatically after the 1973 Amendments. The total HUD payment to NFIA in 1970 was only $51,945. By 1975 that annual HUD payment had risen to $20,829,589. The tremendous growth in the amount of the total payment made it essential for HUD to assert an effective method for prior review and approval of NFIA's planned expenditures.

DEPARTMENTAL RESPONSE

In summary, between 1974 and early 1976 major areas of disagreement between HUD and NFIA became apparent with respect to the authority of the Department to construe the terms of the Standard Flood Insurance Policy, issue interpretations of the policy, and require contracts let by NFIA to be subject to competitive bidding. As a result, on August 30, 1976, the Department asserted its rights under the statute and the June 6, 1969, agreement between it and the NFIA, and promulgated proposed regulations addressing these major areas of disagreement. After the period of public comment closed, the Department decided that resolution of the outstanding issues between HUD and the NFIA could best be achieved by negotiations with the NFIA.

These negotiations began in early September, 1976. The outstanding issues between the parties were identified and refined with a view to entering into a new Part A Agreement. The negotiations, which proceeded through the end of the year and up to a few minutes before midnight on the night of January 19, 1977, resulted in a tentative draft agreement which was published in the Federal Register on January 28, 1977. The "tentative" agreement did not resolve the disputes between the parties. The preamble to the January 28, 1977, publication in the Federal Register clearly sets forth the major item of difference between the parties that had not been resolved by the negotiators.

"A major outstanding issue as to which the Department and NFIA did not reach tentative agreement concerns the effect of regulations and other directives issued by the Administrator on the obligations undertaken by NFIA under the Agreement.

HUD's position throughout the course of these negotiations has been that the Secretary has such regulatory authority over the insurance component of the program and NFIA as is necessary to provide continuing involvement in and supervision of NFIA. HUD maintains that, when agreement on an issue cannot be reached through consultation between the parties, final resolution rests with the Secretary, and the Secretary cannot enter into a contract under which the Secretary would voluntarily agree to contract away the powers of Government.

On the other hand, NFIA's position in the negotiations has been that, while it recognizes that the Secretary has oversight responsibilities under the Act, the relationship between NFIA and the Secretary is contractual in nature and the Secretary may not issue regulations or directives which unilaterally amend that contractual relationship or impose extracontractual obligations on NFIA."

There were, on January 28, 1977, other significant issues still unresolved. Provisions regarding contracting requirements applicable to NFIA with respect to operation of the Computer System remained unresolved. Whether the operation of the Computer System would be contracted out, and if so, what method of contracting would be used, were matters as to which the parties continued to disagree. The Department's position was that the Computer System should be operated by an independent firm rather than by NFIA to assure transferability of the Computer System to HUD or HUD's designee at all times. NFIA was of the view that the agreement between the Department and NFIA should not require NFIA to enter into such a contract, but should leave such determination to NFIA as a matter of business judgment, and that transferability of the Computer System could be assured without contracting the system out to a third party.

NEGOTIATIONS AFTER JANUARY 20, 1977

After this Administration took office, further negotiations were undertaken by HUD and NFIA in March, 1977, in an attempt to resolve the disputed issues and develop a new Part A Agreement. While these negotiations were in progress, the General Accounting Office, on March 21, 1977, issued a report on the NFIA's financial controls over its operations relating to the flood insurance program. That report found numerous weaknesses in NFIA's ability to generate accurate financial data. The report stated:

"Our review of the financial controls of the National Flood Insurance Program showed that NFIA has been unable to generate accurate financial and statistical data. As a result, it can neither produce its own financial statements nor supply FIA with the kind of data it needs to make program decisions, determine subsidy amounts and premium rates, or produce the financial statements for the program."

The findings in the GAO report made urgent successful resolution of the Department's assertion of its regulatory authority over the flood insurance program and emphasized the need for close scrutiny of HUD's financial controls over NFIA operations. However, even after that report was issued, NFIA was unwilling to accept HUD regulation of the insurance and budget aspects of the program. Therefore, in June, 1977, the Department published proposed regulations asserting its supervisory authority over the program.

In a response dated July 5, 1977, NFIA notified HUD of its intent not to renew the 1969 agreement and as a result, the 1969 agreement between HUD and the NFIA will end on December 31, 1977. The NFIA's letter of July 5, 1977, did, however, indicate a willingness to continue to negotiate and attempt to reach a new agreement. In response to that offer the Department once again renewed negotiations with the NFIA in late July.

However, on July 21, 1977, the Department issued a request for proposals (RFP) to operate the flood insurance program. Issuance of the RFP was essential to assure a continued capability to operate the program after December 31, 1977, if a new agreement with the NFIA could not be reached.

The RFP issued on July 21, 1977, included a statement of the work to be performed, the terms of the proposed contract covering that work, the cost plus fixed fee compensation arrangement contemplated, and the factors by which proposals would be judged. Interested offerors were required to submit their proposals by 5:00 p.m. September 23, in order to afford adequate time for evaluation, negotiations and selection. Offerors were free to submit proposals to operate under Part A or Part B of the Act. Selection factors did not weight the RFP towards any particular type of offeror. All offerors who could demonstrate their ability to carry out the work program stood on an equal footing. While the RFP solicitation process was open and competitive, the post-proposal submission and pre-selection procedures left room for negotiation and for fine tuning of proposals and requirements in order to assure a viable and effective contract arrangement and contractor selection.

The renewed negotiations undertaken by HUD and NFIA in late July, 1977, were held to a strict timetable because of the need to determine quickly whether NFIA or a contractor selected pursuant to the July 21, 1977, request for proposals would be utilized by HUD in administering the flood insurance program after December 31, 1977. While substantial progress was made in these negotiations, they were ended on August 16, 1977, because of the inability of HUD and the NFIA to reach agreement on the issue of the Department's right to prior review and approval of NFIA's budget for operating expenses.

The Subcommittee on Housing and Community Development of the House Committee on Banking, Finance and Urban Affairs, concerned with the inability of HUD and NFIA to reach agreement for a contract to operate the flood insurance program under a Part A framework, held hearings on the matter on September 7 and 8, 1977. Witnesses representing HUD and NFIA testified and were closely questioned by members of the Committee as to the reasons for the parties' inability to agree. The members of the Committee at the Hearings made clear their preference for operating the flood insurance program under a Part A framework.

With the benefit of recommendations from interested members of the Committee, negotiations were renewed between HUD and NFIA. In these negotiations NFIA agreed to prior HUD review and approval of each line item, and of the total amount, of its annual operating expenses.

EFFECT OF THE REQUEST FOR PROPOSALS

When NFIA notified HUD, on July 5, 1977, of its intent to terminate its contract relationship with HUD, effective December 31, 1977, HUD issued a request for proposals (RFP) seeking to identify entities interested in replacing NFIA as the entity utilized by HUD in administering the flood insurance program. The RFP was modified a number of times during August and September, 1977. Finally, on September 23, 1977, the RFP produced two proposals from entities interested in replacing NFIA under a Part B arrangement. The interested proposers were Bradford National Corporation (Bradford) and EDS Federal Corporation (EDS).

In accordance with standard procurement practice, the Bradford and EDS proposals were then reviewed by a Source Evaluation Board consisting of HUD officials. On September 30, 1977, the Source Evaluation Board undertook oral discussions of the proposals with EDS and Bradford. The proposers' best and final offers were submitted on October 11, 1977, and considered by the Board on October 12, 1977. Thereafter, the Board recommended to the Source Selection Official (the HUD Under Secretary) that HUD enter into further negotiations with EDS only.

As a consequence of the RFP process and of the proposals submitted, we find that the cost to HUD of using NFIA under Part A of the Act during 1978 will be just under $25 million while the cost to HUD of contracting with EDS to provide the same services will be just under $11 million. Thus, a contract with NFIA for 1978 will be approximately 2½ times more costly to the government than a contract with EDS.

At the time of HUD's testimony before the Subcommittee on Housing and Community Development of the House Committee on Banking, Finance and Urban Affairs on September 8, 1977, we were unaware of a cost divergence of such magnitude. EDS' original offer was submitted September 23, 1977, and its best and final offer was submitted October 11, 1977.

The attached Exhibit 1 compares the costs of doing business with NFIA during 1978 as against the costs of doing business with EDS for that same year. Please note the following points with respect to the data set forth in Exhibit 1.

(1) All figures shown in the EDS column were provided by EDS in its "best and final" offer submission.

(2) All figures shown in the NFIA column constituting its "Total General Expense" were provided to HUD by NFIA.

(3) The figures shown in the NFIA column for "Servicing Carriers," "Claims Adjusting" and "Total Other Federal Costs" are HUD estimates which were essentially confirmed by NFIA in an exchange of letters between HUD and NFIA dated October 19, 1977, and October 21, 1977, attached as Exhibit 2.

(4) The major differences in cost between the EDS and NFIA submissions fall into three major categories: decentralized policy and claims review—approximately $8.3 million; NFIA allowance—approximately $5.4 million; and State Premium Taxes—approximately $3.5 million.

(a) *Decentralized Policy and Claims Review—$8.3 Million.* The immediate operating expenses of EDS and NFIA (direct costs and overhead) are substantially equal. (See comparative figures next to the "Total General Expense" item.) However, note the marked difference in the item captioned "Total Operating Expense"—the amount for NFIA is almost twice the amount for EDS. This discrepancy results primarily from NFIA's decentralized method of performing policy and claims review functions under fee arrangements with Servicing Carriers which are, with few exceptions, members of NFIA. Indeed, the 15-member Executive Committee of NFIA, whose combined voting strength controls the 132-member NFIA, has been getting about three-fourths of the fees paid under these fee arrangements.

EDS proposes to carry out a centralized program of policy servicing and claims review which will not involve the payment of similar fees. The centralized method of performing policy and claims review functions will not affect the use of independent agents and claims adjusters who now provide services in the nearly 16,000 communities participating in the flood insurance program. It will, however, dispense with the 46 servicing locations NFIA now utilizes to perform policy and claims review.

(b) *NFIA Allowance—$5.4 Million.* Under the terms of the existing contract with HUD and under the terms of the proposed contract which we have negotiated for 1978, NFIA receives an annual "operating allowance" equal to 5 percent of policyholder premiums. NFIA characterizes the operating allowance as a quid pro quo for an annual pledge by NFIA member companies of risk capital (approximately $48 million) for the payment of extraordinary losses under the Flood Insurance Program. The operating allowance can be regarded as an annual premium paid by HUD to the insurance carriers participating in the Flood Insurance Program for extraordinary loss insurance coverage. The HUD annual premium rate is over 10 percent of the face amount of the NFIA members pledged risk capital. Moreover, when all the financial provisions of the draft contract which determine the extent of NFIA's liability in the event of catastrophic losses are taken into account, HUD's annual premium rate for that coverage climbs to 50 percent of NFIA's actual risk.[1] Since the inception of the Flood Insurance Program, participating insurance carriers have not had to actually "pay out" on their pledge of risk capital despite the occurrence of a number of significant flood disasters during that time period. Furthermore, during 1978, we would have to experience a flood disaster far exceeding anything which has occurred during the life of the Flood Insurance Program, in order for the participating insurance carriers to actually pay out anything in return for HUD's annual premium of $5.4 million.

[1] If in 1978 a tidal wave swept from coast to coast, destroying every structure in the country, the NFIA maximum loss would be $10,469,000. The NFIA charge to HUD for assuming this risk for 1978 is $5,366,000, or 51 percent of their maximum loss exposure.

It is almost impossible to objectively assert the value to the Government of the "risk sharing" provided by the NFIA annual operating allowance. However, on the basis of the loss experience to date, the conclusion that the amount of the allowance is excessive, seems inescapable. By comparison to the 51 percent per annum "premium" implicit in the "operating allowance" required for a maximum risk exposure in 1978 of $10.5 million, automobile liability insurance premiums run around one percent per year of the limit of liability of those policies. Premiums for true low exposure insurance, such as accidental death and disability coverage, are considerably less than premiums for automobile liability coverage. It is not unreasonable to assert that the premium rate for the extraordinary Flood Insurance Program risk coverage purchased by HUD through the NFIA allowance is more a function of lack of competition for this insurance business than of actual risk.

(c) *State Premium Taxes—$3.5 Million.* The column for NFIA shows a cost in excess of $3.5 million for the payment of State premium taxes. There is no counterpart cost figure in the EDS column. NFIA points out that like any other insurance company, it pays these taxes on flood insurance policies sold in accordance with requirements of State law and that this cost item "bears no relation to the efficiency of the contractor." For purposes of this report, this point can be admitted although we are not convinced that NFIA has achieved maximum efficiency in its State premium tax payments. We are absolutely certain, however, that payment of State premium taxes would not be required in connection with a Part B Government Program with Industry Assistance.

In summary, as a result of the RFP we have learned that the cost to HUD of doing business with NFIA during 1978 would exceed by approximately $15 million the cost to HUD of doing business with EDS during that same year. The form of the services provided by NFIA and EDS is not identical (i.e., EDS will have a centralized operation, NFIA will have a somewhat more, but not fully, decentralized operation). The difference (if any) between providing services on a more decentralized basis plus the element of risk (if any) borne by NFIA constitutes the sum of the services provided by NFIA and not by EDS. It is very hard to ascribe any dollar value, either to the consumer who participates in the National Flood Insurance Program or the Government, of NFIA's decentralized operation plus its risk sharing. It is impossible for a reasonable person to conclude these two items are worth approximately $15 million.

HUD's analysis of the EDS proposal for a centralized operation indicates that it offers great opportunity for more efficient service as well as cost savings. We would also emphasize here that such a centralized operation will not affect the use of independent agent and claims adjuster units as the fully decentralized link with the consumer. In fact, we believe those independent agent and claims adjusters' units will be able to provide better consumer service when they are backed by the more efficient paper handling mechanism proposed by EDS.

The use of EDS will not increase the size of HUD staff.

PERTINENT FINDINGS

(1) A March 21, 1977, report by the General Accounting Office found numerous weaknesses in the ability of the Pool to generate accurate financial and statistical data. The Pool has not since the date of that report satisfactorily responded to the Department's requests that it submit evidence that it has improved its operations to eliminate or significantly ameliorate the problems identified by the Comptroller General.

(2) The Pool has, during its tenure under the agreement which established the relationship between it and the Government and enabled the flood insurance program to be implemented under Part A, refused to comply with the Secretary's interpretations of the scope of coverage of the Standard Flood Insurance Policy, basing its refusal upon the conflicting private sector interests of its members, and refused to competitively bid its service contracts.

(3) At the present time a contract to administer the National Flood Insurance Program under a Part A framework would be $15 million higher for 1978 than a contract to administer the Program under a Part B framework. The amount by which the cost under a Part A framework will exceed the cost under a Part B framework will grow larger in succeeding years.

(4) Our analysis of the offers to participate under Part A and Part B frameworks reveals no advantages to the Government or to consumers who participate in the National Flood Insurance Program that would result from a decision to ignore the higher cost of a Part A framework.

EXTENT OF UTILIZATION OF INSURANCE INDUSTRY UNDER PART B

Our intention, in implementing a continuing program of national flood insurance under Part B of the Act, is to utilize private sector insurers, insurance agents and brokers, and insurance adjustment organizations to the maximum extent practicable in providing flood insurance coverage and adjusting claims under the program. Although a private sector fiscal agent-contractor will be utilized in place of a pooling arrangement, there will be no diminution in the use of insurance agents and brokers and insurance adjustment organizations whose relationships with the National Flood Insurance Program will not be affected in any material way by virtue of the transition from a pooling arrangement to a fiscal agent. All insurance agents and procedures manuals and forms presently utilized in the program, including the Standard Flood Insurance Policy, will continue to be utilized in much the same manner as these instruments are in use today to avoid any disruption in services being rendered by insurance organizations presently serving the program. There will be no change or even interruption in services provided to the program's policyholders. The consumer will not be adversely affected by the change to a Part B program.

RECOMMENDATIONS

(1) As presently written, the National Flood Insurance Act provides no guidance as to an appropriate rate of return on risk capital pledged by a Pool of insurers under a Part A framework. It is not feasible to develop competitive Pools of insurers willing to participate in the flood insurance program under a Part A framework. Absent the market constraints that would be imposed by a competitive situation, it is extremely difficult, solely through negotiation, to reach agreement on a reasonable rate of return on pledged risk capital without some legislative assertion of acceptable parameters. Experience gained from working under a Part A framework leads us to recommend that Congress consider establishing legislative guidelines for the return on pledged capital that insurers participating under a Part A framework should receive.

(2) Our experience working under a Part A framework leads us to recommend that Congress make explicit that the Federal Agency administering the flood insurance

program under a Part A framework may, by the proper exercise of regulatory authority, amend the provision of any contract with a Pool of Insurers participating in the flood insurance program so long as the increased costs caused by the proper exercise of regulatory authority is borne by the Government.

(3) Our experience working under a Part A framework leads us to recommend that Congress consider requiring that sub-contracts of the Pool of Insurers participating in the flood insurance program under a Part A framework be subject to Federal audit and competitive bid requirements.

		EDS (centralized)	
	NFIA (1978)	Year 1	Year 2
Salaries [1]	$2,652,000	$4,112,061	$4,230,027
Data processing [2] (development and operations)	2,117,000	508,268	513,989
Legal, audit, and consulting [3]	184,000	54,500	58,000
Travel [4]	150,000	370,520	208,882
Printing [5]	750,000	517,810	435,887
Map distribution [6]	1,000,000	448,720	538,404
Telephone [7]	200,000	120,100	142,440
Postage [8]	819,000	1,118,000	1,376,200
Rent (space) [9]	183,000	427,245	427,245
Advertising/public relations [10]	159,000	20,000	20,000
Furniture and equipment [11]	204,000	131,833	99,277
Other [12]	112,000	191,490	102,800
Corporate allocation and G&A		731,209	729,403
Taxes		199,644	179,836
Total general expense	8,539,000	8,951,315	9,059,439
Servicing carriers [13]	6,931,000		
Claims adjusting [14]	1,352,000		
Total operating expense	16,822,000	8,951,315	9,059,439
NFIA allowance [15]	5,366,000		
State premium taxes [16]	3,541,000		
Printing and marketing [17]		453,000	453,000
Transition [18]		660,000	
Fee [19]		895,132	905,944
Total other Federal costs	8,907,000	2,008,132	1,358,944
Total program costs	25,729,000	10,959,447	10,418,383

[1] NFIA salaries based on 170 staff-years. EDS salaries based on about 257 staff-years each year. EDS staffing reflects centralization of functions.

[2] NFIA budget includes $867,000 for operations as compared to $510,000 porposed by EDS. Difference is result of NFIA buying computer time in the commercial market while EDS is charging their internal rate. NFIA budget includes $1,250,000 for systems development by outside consultants (Arthur Andersen). Effort will be performed by EDS with inhouse staff.

[3] NFIA is more dependent on purchasing services rather than using inhouse staff. NFIA figure includes audit costs. EDS figure does not, although it is included elsewhere.

[4] EDS operation has increased travel requirements as a result of centralization of operations and the need for contact with agents and the public in the field—$178,000 of employee relocation costs included in EDS's first year.

[5] FIA will be providing some forms to EDS which have been provided by NFIA. Increase in cost to FIA is included at footnote 17.

[6] EDS included map postage expense of $84,000 under postage. NFIA's total figure is based on historical experience plus an increase reflecting certain recent changes in map distribution re uirements.

[7] NFIA budget includes wats lines installed at 18 servicing carrier locations.

[8] EDS proposal included map distribution postage and "information" mailing to agents, policyholders, etc.

[9] NFIA presently leasing 20,400 ft² at about $7.60/ft². EDS proposing 20,000 square feet at $10.50 per square foot.

[10] NFIA currently provides workshops and other marketing functions. EDS proposal provides staffing for these functions, but costs were excluded pending receipt of specific directions from FIA. The cost of the marketing functions is included at footnote 17.

[11] NFIA budget includes $50,000 for office supplies. Some of the costs included elsewhere in EDS proposal.

[12] $111,000 of onetime, startup recruiting expenses included in EDS's first year.

[13] Projection based on $8.75 per new policy and $4 per renewal policy, with larger percentage of renewals as opposed to new policies.

[14] Projected based on $45 per claim.

[15] Projected based on 5 pct of premiums for present HUD/NFIA agreement.

[16] Projected based on historical average of 3.8 pct of premiums.

[17] See footnotes 5 and 10 above.

[18] Includes onetime startup costs.

[19] Fixed fee based on 10 pct of EDA's costs.

BOB G. ODLE, Esq.,
Hogan & Hartson,
815 Connecticut Avenue, N.W.,
Washington, D.C. 20006.

OCTOBER 19, 1977.

DEAR BOB: As you know, the Department intends to seek Congressional views of the form in which the flood insurance program is to be continued. The material which we received from Frank Nutter on those items which are not included in your proposed Exhibit A to the draft contract but are part of the overall cost to the Government of a Part A arrangement with NFIA, was helpful. However, the submission did not contain any dollar amounts or other breakdown for those items Our estimates of those costs, based on our assumptions of policy volume and your organizational structure, are attached. Given the extremely tight time frame in which the Department is operating, we request that you confirm or correct our estimates by noon Friday, October 21.

In informing the relevant committees of Congress of the status of the flood insurance program, we intend to state that NFIA has accommodated HUD's concern that HUD did not have appropriate prior control of expenses, as that issue was defined before the House Subcommittee at the September hearings.

Sincerely,

EDWARD W. NORTON,
Deputy General Counsel.

Attachments.

NFIA BUDGET FOR FISCAL YEAR 1978

Salaries	$ 2,652,000
Data processing (development and operations)	2,117,000
Legal, audit and consulting	184,000
Travel	159,000
Printing	750,000
Map distribution	1,000,000
Telephone	200,000
Postage	819,000

NFIA BUDGET FOR FISCAL YEAR 1978—Continued

Rent (space)	$183,000
Advertising/P.R.	159,000
Furniture and equipment	252,000
Other	64,000
Total general expense	[1] 8,539,000
Servicing carriers	[2] 6,931,000
Claims adjusting	[3] 1,352,000
Total operating expense	16,822,000
NFIA allowance	[4] 5,366,000
State premium taxes	[5] 3,500,000
Total other part A costs	8,866,000
Total program costs	25,688,000

[1] Based on the NFIA Budget.

[2] Projected based on $8.75 per new policy and $4.00 per renewal policy.

[3] Projected based on $45.00 per claim.

[4] Projected based on 5 percent of premiums per present HUD/NFIA agreement.

[5] NFIA estimate per letter dated Oct. 17, 1977.

OCTOBER 21, 1977.

By Messenger
Edward W. Norton, Esq.,
Deputy General Counsel, Department of Housing and Urban Development, 451–7th Street, S.W., Washington, D.C. 20410

DEAR ED: This is in response to your letter of October 19, 1977. We are gratified that our negotiations are successfully concluded and that HUD finds acceptable the contract which was negotiated. We look forward to an early signing date.

As requested, NFIA has reviewed the budget and cost estimates appended to your letter. NFIA's comments thereon are enclosed. We trust you will include our explanatory notations in any Part A vs. Part B submission you make to the Secretary and to Congress.

We have also enclosed the form of servicing company contract which was agreed upon by use and Bill Cumming of your staff on August 8, 1977. This is the document referred to as Exhibit C in the new NFIA/HUD agreement.

Sincerely,

BOB GLEN ODLE.

Enclosures.

NATIONAL FLOOD INSURERS ASSOCIATION

NFIA COMMENTS ON BUGET AND COST ESTIMATES APPENDED TO OCTOBER 19, 1977 HUD LETTER TO HOGAN & HARTSON

OCTOBER 21, 1977.

1. *HUD's Note A.* The figure listed as "Total General Expense" is identical to operating cost figures previously submitted by NFIA. A copy of NFIA's Operating Budget for FY 1978 is attached.

2. *HUD's Notes B and C.* These items represent the payment of fees for policy processing and claims supervision in a fully decentralized, nationwide network of insurance companies. On the basis of assumptions apparently made by HUD, HUD's figures of $6,931,000 for "servicing carriers" and $1,352,000 for "claims adjusting" appear reasonable, with two caveats. First, because these fees are directly related to sales and claim activity, a significant upward or downward shift in sales volume or claims activity would materially affect the estimates. Second, under the terms of the new contract between NFIA and HUD, NFIA will be reviewing the structure of the current servicing network and, during fiscal year 1978, begin to competitively relet all servicing company con-

tracts, NFIA is unable to predict what the competitive selection process will produce.

3. *HUD's Note D.* The term "NFIA Allowance" for this item is a misnomer. HUD's figure of $5,366,000 actually represents HUD's estimate of the maximum possible return to NFIA members for their capital commitment to the flood insurance loss exposure of the program based upon an assumed $107 million in written premiums. Such an item should not be considered as a cost to the program. It is, in fact, a return on risk capital which may well be significantly below HUD's estimate. Program statistics demonstrate that member companies could possibly receive no return on pledged capital for 1978, but instead may be called upon to pay flood losses from their pledged capital. For this item to be appropriately considered as a cost to the program, it should be calculated over an extended number of years. Because of the nature of the risk capital, it is inappropriate to attempt to measure the amount of the item, if any, for any given year. The inclusion of such a figure in any estimate of total program costs may misrepresent the true costs of a Part A program, and fails to assess the potential for capital contribution.

4. *HUD's Note E.* The government does not share in the payment of state premium taxes. Although the payment of these taxes is a cost of doing business, they bear no relationship to the operating efficiency of NFIA's performance.

National Flood Insurers Association budget operating costs—fiscal year September 30, 1978

[In thousands]

Salaries:		
Wages	$2,210	
Benefits	442	$2,652
Marketing, communications, media relations, research, and advertising		150
Telephone		200
Rent		183
Postage and express		810
Printing		750
Travel		150
CLS subscription		24
Temporary agency hires		40
Office supplies:		
Supplies	50	
Reproduction	38	
Microfilming	68	
Equipment and furniture	50	
Other	48	252
Legal		24
Audit		80
Consulting		80
Data processing:		
Operations	867	
Development	1,250	2,117
Map distribution		1,000
Total		8,539

[FR Doc.77-32584 Filed 11-9-77;8:45 am]

[4310-84]

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

ALASKA

[F14954-A]

Alaska Native Claims Selection

On November 15, 1973, Olgoonik Corp., for the Native village of Wainwright, filed selection application F-14954-A under the provisions of section 12 of the Alaska Native Claims Settlement Act of December 18, 1971 (85 Stat. 688, 701; 43 U.S.C. 1601, 1611 (Supp. V, 1975)) for the surface estate of certain lands in the Wainwright area.

As to the lands described below, the application, as amended, is properly filed and meets the requirements of the Alaska Native Claims Settlement Act and of the regulations issued pursuant thereto. These lands do not include any lawful entry perfected under or being maintained in compliance with laws leading to acquisition of title.

In view of the foregoing, the surface estate of the following described lands, selected pursuant to section 12(a), aggregating approximately 4,984 acres, is considered proper for acquisition by Olgoonik Corp. and is hereby approved for conveyance pursuant to section 14 (a) of the Alaska Native Claims Settlement Act:

UMIAT MERIDIAN, ALASKA (UNSURVEYED)

T. 16 N., R. 30 W.,
Sec. 8, all.

Containing approximately 640 acres.

T. 15 N., R. 31 W.,
Sec. 17, excluding PLO 1851;
Sec. 18 (fractional), excluding PLO 1851 and Tract B of U.S. Survey 4418;
Secs. 20 and 21, excluding PLO 1851;
Secs. 28 and 29 (fractional), excluding PLO 1851;
Sec. 33 (fractional), excluding PLO 1851.

Containing approximately 3,398 acres.

T. 15 N., R. 32 W.,
Sec. 13 (fractional), excluding PLO 1851.

Containing approximately 36 acres.

T. 14 N., R. 33 W. (fractional),
All.

Containing approximately 910 acres.

The conveyance issued for the surface estate of the lands described above shall contain the following reservations to the United States:

1. A right-of-way thereon for ditches and canals constructed by the authority of the United States, as prescribed and directed by the act of August 30, 1890, 26 Stat. 391, 43 U.S.C. 945;

2. A right-of-way thereon for the construction of railroads, telegraph, and telephone lines, as prescribed and directed by the act of March 12, 1914, 38 Stat. 305, 43 U.S.C. 975d;

3. The subsurface estate therein, and all rights, privileges, immunities, and appurtenances, of whatsoever nature, accruing unto said estate pursuant to the Alaska Native Claims Settlement Act of December 18, 1971 (85 Stat. 688, 705; 43 U.S.C. 1601, 1613(f) (Supp. V, 1975)); and

4. Pursuant to section 17(b) of the Alaska Native Claims Settlement Act of December 18, 1971 (85 Stat. 688, 708; 43 U.S.C. 1601, 1616(b) (Supp. V, 1975)), the following public easements, referenced by easement identification number (EIN) on the easement map in case file F-14954-EE, are reserved to the United States and are subject to further regulation thereby:

a. (EIN 1 C5, E) An easement for the existing trail along the Chukchi seacoasts, twenty-five (25) feet in width, through the selected lands and village lands to public lands to the north and south. The usage of roads and trails will be controlled by applicable State or Federal law or regulation.

b. (EIN 2 C5, E) An easement one hundred (100) feet in width for a proposed road located along the alignment proposed by the Alaska Department of Highways from Wainwright easterly towards Barrow, through the selected lands and village lands to public lands to the north and east. The usage of roads and trails will be controlled by applicable State or Federal law or regulation.

c. (EIN 4 D1, C4) A continuous linear easement twenty-five (25) feet in width upland of and parallel to the mean high tide line in order to provide access to and along the marine coastline and use of such shore for purposes such as beaching of watercraft or aircraft, travel along the shore, recreation, and other similar uses. Deviations from the waterline are permitted when specific conditions so require, e.g., impassable topography or waterfront obstruction. This easement is subject to the right of the owner of the servient estate to build upon such easement a facility for public or private purposes, such right to be exercised reasonably and without undue or unnecessary interference with or obstruction of the easement. When access along the marine coastline easement is to be obstructed, the owner of the servient estate will be obligated to convey to the United States an acceptable alternate access route, at no cost to the United States, prior to the creation of such obstruction.

d. (EIN 6 C) The right of the United States to enter upon the lands hereinabove granted for cadastral, geodetic, or other survey purposes is reserved, together with the right to do all things necessary in connection therewith.

e. (EIN 7 C) Easements for the transportation of energy, fuel, and natural resources which are the property of the United States or which are intended for delivery to the United States or which are produced by the United States. These easements also include the right to build any related facilities necessary for the exercise of the right to transport energy, fuel, and natural resources, including those related facilities necessary during periods of planning, locating, constructing, operating, maintaining, or terminating transportation systems. The specific location of these easements shall be determined only after consultation with the owner of the servient estate. Whenever the use of such easements will require removal or relocation of any structure owned or authorized by the owner of the servient estate, such use shall not be initiated without the consent of the owner of such improvement: *Provided, however,* That the United States may exercise the right of eminent domain if such consent is not given. Only those portions of these easements that are actually in use or that are expressly authorized on March 3, 1996, shall continue to be in force.

f. The agreement of May 14, 1974, between the United States Department of the Navy, the Arctic Slope Regional Corp., Olgoonik Corp., and three other Arctic Slope village corporations reserves those easements necessary to implement said agreement. A copy of the agreement is loacted in Bureau of Land Management file F-14954-EE.

The grant of lands shall be subject to:

1. Issuance of a patent confirming the boundary description of the lands hereinabove granted after approval and filing by the Bureau of Land Management of the official plat of survey covering such lands;

2. Valid existing rights therein, if any, including but not limited to those created by any lease (including a lease issued under section 6(g) of the Alaska Statehood Act of July 7, 1958 (72 Stat. 339, 341; 48 U.S.C. Ch. 2, Sec. 6(g) (1970))), contract, permit, right-of-way, or easement, and the right of the lessee, contractee, permittee, or grantee to