# LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM, PART II

## HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING, AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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# LEGISLATIVE PROPOSALS TO REFORM THE NATIONAL FLOOD INSURANCE PROGRAM, PART II

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**Friday, April 1, 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 10:35 a.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Dold, Stivers; Waters, Cleaver, and Sherman.

Also present: Representatives Walberg, Palazzo, Schweikert, and Green.

Chairwoman BIGGERT. The Subcommittee on Insurance, Housing, and Community Opportunity will come to order.

We are delighted to have Administrator Fugate of the Federal Emergency Management Agency (FEMA) with us today, and we thank you so much for being here. We are very sorry that you could not be at our last hearing, but that certainly was understandable.

As a reminder, it was the day of the earthquake and the tsunami, and obviously, FEMA was very much engaged in that. So, thank you for giving us the opportunity to have you here to talk about the flood bill.

We have decided between the ranking member and myself that opening statements will be made a part of the record, so that we can get right to your testimony.

I would now like to introduce Administrator Fugate. As is our usual policy, you will have 5 minutes to summarize your testimony, although we do have some leeway when you are here. After that, we will have the opportunity to ask questions at 5 minutes each.

So, if you would like to proceed, please do.

## STATEMENT OF THE HONORABLE W. CRAIG FUGATE, ADMINISTRATOR, FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA)

Mr. FUGATE. Good morning, Chairwoman Biggert, Vice Chairman Hurt, and the distinguished members of the panel.

I think it is kind of interesting that my testimony—which again, we very much appreciate the committee's indulgence in allowing me to come back at another date—dealt with an earthquake that produced tsunami warnings for our territories, the States of Hawaii, California, and Alaska, with advisories for the rest of the coastal areas.

In that, it was, I think, very appropriate that on the day of testifying about the National Flood Insurance Program (NFIP), we saw one of the hazards which would have put immediate and tremendous stress upon the Flood Insurance Program—a tsunami, rising water damages.

And I think this is one of the challenges when we talk about hazards, in that when we look at how we manage risk, for most of us, we manage our risk through insurance, whether we are driving our car or protecting our home against fire or other types of casualties.

But in the realm of flood insurance, since 1968 it has been the responsibility of the Federal Government to make that insurance available and the homeowners' policies that most people have will not cover damages from rising water. Only a flood insurance policy provides that protection. And that rising water may be caused by hurricanes, tsunamis, heavy rainfall events, riverine flooding or other matters which could cause those types of damages.

Over time, this program has evolved to try to mitigate this risk by ensuring that communities that participate in the Flood Insurance Program take the steps to mitigate future growth and development. You have funded the Federal Emergency Management Agency to update maps to provide better and more detailed data, oftentimes generating even more issues as that data may show increased or decreased risk.

We have a requirement in the statute that, if you have a federally-backed mortgage in an area that is deemed high risk—a 1 percent risk or higher—that as part of your federally-backed mortgage, you need to protect that mortgage with flood insurance.

We have built this program to fill the need of how do we provide protection to homeowners, and also to the mortgage industry, against a hazard that the private sector does not offer to the average homeowner? And that program has, over the years, been amended to address the issues that have occurred in previous floods.

But after Hurricane Katrina, another issue arose, and that was the tremendous exposure to the taxpayers for the losses incurred. Originally, close to $19 billion had to be borrowed from the U.S. Treasury to pay those claims. Currently, that debt has dropped.

But it is unlikely that FEMA will ever be able to retire completely the Katrina-Rita-Wilma debt, based upon our current rate of collection and our current rate of payments due to ongoing and reoccurring floods.

We are very much engaged with our stakeholders, and have been for the last almost 20 months, in asking the question: What are the next steps we need to take in the National Flood Insurance Program to address both the concerns that have been raised by Katrina and other disasters, but also the issue that is raised by members of this committee, as well as your fellow Members of Congress, about the cost and affordability of these products that are so necessary to provide and protect the financial well-being of those that have property they are insuring?

And lastly, the draft reauthorization. Having heard this from numerous constituents, I must again, I think, agree with the direction the committee has taken for a 5-year reauthorization.

Of all of the things—and I think there are a lot of things in the bill we would like to work with you on—the one thing that I have heard loud and clear from the insurance industry, the Write Your Own Companies, from the homebuilders, from the REALTORS®, is short-term extensions of this program are detrimental to those organizations that depend upon the stability of a Flood Insurance Program to be able to continue to provide policy support, but more importantly, the sale and home ownership where federally-backed flood insurance may not be available during short-term lapses in reauthorization.

So, we are very much in support of the 5-year reauthorization timeframe.

And that will conclude my statement. I am ready for your questions.

[The prepared statement of Administrator Fugate can be found on page 21 of the appendix.]

Chairwoman BIGGERT. Thank you so much, Administrator.

I will start with the questioning.

But before I do that, I would like to ask unanimous consent to allow members to participate who are not on the subcommittee. We have one here now, Mr. Walberg from Michigan, and then Mr. Palazzo from Mississippi. And we may be joined by Mr. Schweikert from Arizona.

Without objection, they may participate.

Administrator, the NFIP calculates the premium rates it charges for flood insurance coverage based on average annual losses. But then it provides C grade discounts for a subset of high-risk properties that have been essentially subsidized by other NFIP policyholders and the Federal taxpayers.

How important is it for the NFIP to move as rapidly as possible to full risk rates for all properties? And what do you see as the timeline for that to happen?

Mr. FUGATE. I think it is a direction that Congress needs to make clear, that when we do this, there will be people who will come back to you and feel that they are unfairly being charged new costs that they are being told they must pay.

And I think this comes back to really communicating the Flood Insurance Program's purpose. It is not to produce an unfunded mandate or burden. It is an insurance program which we administer, which has—our responsibility to taxpayers is to insure, as close as possible at the direction of Congress, what risk general taxpayers should assume versus the homeowner or person benefiting from the property should assume for that risk.

Because of moving towards more actuarially-based rates, some would see in many cases in the higher-risk areas, increases in those premiums.

The tendency has been, as constituents have raised the issue of the fairness of that, that there has been a question of how fast we should move. We will move as fast as Congress directs in allowing us to raise those rates.

But I think we also need to be realistic that there will be some pain in that process. And that pain will be registered with constituents concerned about the accuracy of the mapping, the validity of whether or not these rate increases are warranted, and something that I have heard numerous times, that the only reason we are doing this is to pay off the existing debt load, not really look at the future impacts of losses to the NFIP.

Chairwoman BIGGERT. Thank you.

Will you have to wait for the mapping of some places, and how long does a mapping really take?

Mr. FUGATE. I would hate to say there is an average timeframe. The process that we engage in when we meet with the locals to begin the map update really depends upon what is the quality of the existing data we are working from. How much new data will be required to do those maps, and then the engineering of that, then the outreach for the community as we go through the resolution?

So, it is a several-year process from the time we start, and we begin by issuing the preliminary maps.

But through an appeals process, and also through a—and answering the question of the validity of some of the assumptions in the planning, we have put together a scientific resolution panel to do a final review on maps to make recommendations for changes if appropriate.

So, depending upon that, you could easily see that another year or two could be added into the review, appeal, and final determination of those maps.

Chairwoman BIGGERT. Okay. Then over the past 5 years, FEMA has paid more than $2 billion, the interest payments to service the debt, and nearly $2 billion more to reduce it. But, FEMA still owes about $17.75 billion to taxpayers. Many have asserted that, and as you mentioned, the ability to ever repay it is in doubt.

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

Mr. FUGATE. Unlike in the private sector, which can distribute its risk across investments and across different risks, we are solely invested in one risk. That risk does not give us the ability to utilize any type of tools that the private sector would have in the reinsurance markets or distributing that risk to other hazards.

Given the current scenario, I think we would be good not adding to that debt, much less paying it down. I think our exposure in numerous areas of this country where we do have a high participation rate in flood insurance with large-scale flooding, hurricane or tsunami events could further add to that debt.

So, I do not really think it is within the realm of what we are looking at right now with the existing structures we have, that we would make a significant impact unless we had no loss greater than our annual rate of payouts, that we continue to be able to pay back into the flood insurance fund and pay down that debt, and all things being equal, somehow we increase the number of people who participate in the Flood Insurance Program to further distribute that risk.

But since the only requirement to buy flood insurance is on those who have the highest risk, it is unlikely you are going to distribute that risk far enough to actually see the ability long term to guarantee any ability to pay down. I think the exact opposite happens.

Not only do I not see this debt being paid down, except over a very long time with no outstanding catastrophic flood events, I think the reality is, we have a greater risk of that going up with something as straightforward as another hurricane striking in the Gulf Coast or the Atlantic Coast area. The debt as currently structured is not, as I see it, going down.

It is long-term, dependent upon nothing new happening. And the only way I see us looking at this—and this is one of the things that we were very excited to see in the discussion draft, some of the provisions about looking in the private sector through pilot projects—without some ability to look at what other tools would be available to us, unless you require more people to purchase flood insurance and distribute that risk further, I think it will still be very difficult to retire that debt.

Chairwoman BIGGERT. So it really is important to have more private sector participation?

Mr. FUGATE. Private sector participation or hybrids where we can utilize and maybe get the private sector engaged in some of the ways of distributing risk.

I think this is one of the things that—we do not think this is an either/or. We do not think full privatization of the Flood Insurance Program would be achievable unless there were some changes. I am not sure what those would be.

And I do not think that a fully government-run program is successful in the long term.

I think looking at what are the conditions we could set to engage the private sector, and either participation and direct provision in those areas where they can manage the risk, recognizing we may still have to provide protection for the highest risk, or utilize tools that they have with reinsurance to distribute this risk, and look at that from the standpoint of protecting the exposure to future claims.

Chairwoman BIGGERT. Thank you. I would ask you about what are the barriers and regulatory barriers to private sector, but my time has expired.

So I will turn to Ms. Waters, from California, for 5 minutes.

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

I would like to thank Mr. Fugate, the Administrator of FEMA, for being here this morning.

I have some other questions I would like to ask. But continuing along the lines that Ms. Biggert has been questioning you, you pay interest on this debt to the Treasury. Is that right?

Mr. FUGATE. Yes. And that rate is adjusted annually. We have a very low rate.

Again, if that rate was raised, I doubt we would be making any impact to principal. Because Treasury is currently giving us an extremely low rate, we have been able to retire some of the principal debt in addition to the interest payments.

Ms. WATERS. What do you mean when you say extremely low?

Mr. FUGATE. I would have to ask my staff to get back to you in writing, but it is less than the commercial rate or the general rates that you would have for Treasury loans.

[The following information was received after the hearing: "The average interest rate on the National Flood Insurance Program borrowing of $17.75 billion of borrowing is currently 0.323%. The largest note ($16.7 billion) carries an interest rate of 0.25%.]

Ms. WATERS. Has there ever been any discussion about forgiving the debt? Not forgiving the entire debt, but forgiving the—not reducing the interest rate, but wiping out the interest rate, not having an interest rate on that debt—interest-free loan?

Mr. FUGATE. It has been discussed outside of FEMA. We have been looking at that as part of Flood Insurance Program reform. And we do not have the ability to forgive the debt. That is something, literally, that is a fiscal decision.

And the fact that we have been able to make some progress in retiring that debt shows that we can in certain circumstances continue to pay down principal.

But it is, I think, a question that has to be asked. With that outstanding debt, is it the intention to continue to utilize these programs and try to distribute risk so we can continue to pay down that principal or do something else with it?

I would suggest that, in looking at some of the ideas that we have seen in the proposed legislation and the possibility of privatization, there may be some ability to pay down that debt, if we are engaging other parts of the team.

Ms. WATERS. Rather than forgiving the debt, really what I think perhaps is more reasonable and could help somewhat, is to waive the interest rate on the debt.

So, without going any further into that, I really want to get to what happens when our constituents challenge you on the maps. I happen to have had the opportunity to be involved with some of my constituents who organized their community and did a lot of work themselves, and challenged FEMA. And they were successful.

But I do not understand whether or not there is a prescribed way by which our residents can get involved in a process to challenge the mapping. And whether that is on the Internet, now how does that work? Or do they just have to find out and do it the best way that they possibly can?

Mr. FUGATE. I am not sure how an individual—because when we are doing the mapping, we work through the community that is the taxing authority or the jurisdiction for the area of mapping. So, we generally do it through the process of the city adopting the maps, through their public hearings. And that is when, generally, the public engages in those activities.

We also do the—

Ms. WATERS. Let me interrupt you just for a minute, because I only have so much time.

We discovered in this community that the City of Los Angeles had not responded in any shape, form or fashion to the notification I guess they get from FEMA. And it was just lost. It was not done.

So, what happens in that case?

Mr. FUGATE. I would like to be able to respond back in writing to your question. But I think you are raising a valid point we see time and time again, the disconnect between the formal process of adoption, and then when those changes come out, how the public was notified other than just receiving a notice that they are now in a high-risk area and are required to purchase flood insurance.

I think that is something we would also like to work on, how we engage the public as maps are going through the planning process, not through the implementation process. And again, that is something I think we can work with the committee on, particularly in the bill and some of the pilots.

Ms. WATERS. My staff has indicated that it could cost a homeowner over $1,000 to have their home removed from a floodplain. Low-income homeowners are less likely to have these resources than higher-income homeowners.

What kind of assistance does FEMA provide to homeowners who would like to remove their homes from a floodplain? Do you believe that FEMA should provide resources to low-income homeowners?

As I mentioned, in the community that I worked with on this issue, they organized. They had a neighborhood homeowners' association. And they had some individuals who were pretty bright, pretty smart. And they went out and measured curbs and did a lot of stuff, and they were able to prevail.

But what if an individual homeowner is challenging the mapping? What do they do? And how do we get to this $1,000 figure that it would cost them?

Mr. FUGATE. I am not sure if the question is how much it would cost them to challenge or appeal their base flood elevation, or to buy out the property. If it is the base flood elevation, the engineering—

Ms. WATERS. To have their home removed from a floodplain costs about $1,000.

Mr. FUGATE. Okay, I understand. So, this is going back, and we do allow individuals to come back. If they can demonstrate the elevation of the lowest adjacent grade of their home is higher than the base flood elevation, it takes them out of that special risk.

And, yes, there is a cost to that. And, no, we do not have the funds or the program to offset that for low-income people.

That is a challenge that we have with these programs. How do we deal with the income inequities of a program that, when you do not have the funds available to challenge the maps, you may find yourself in the Flood Insurance Program? But if you do have your own funds, you can get yourself taken out.

And as designed, the program does not currently provide that kind of specific assistance to low-income people or what that level of assistance would be.

Ms. WATERS. Thank you, Madam Chairwoman. I yield back.

Chairwoman BIGGERT. Thank you.

I have one more unanimous consent request, for Mr. Green of Texas, who is a member of the Financial Services Committee, but not of this subcommittee, to be able to participate.

Without objection, it is so ordered.

Mr. Hurt, our vice chair, for 5 minutes?

Mr. HURT. Thank you, Madam Chairwoman.

And thank you, Mr. Fugate, for making time to come back and appear before this committee.

I was glad that you noted as you did, that this hearing is coming on the heels of a horrible tragedy in Japan that obviously had an effect here in the United States. And I think it is worth noting for all of us that we were very blessed and fortunate that we did not have more damage than we did, and that under different circumstances, we could have suffered the same type of impact that Japan did, a Katrina-type event, and that is something I think we should all and can be thankful for.

I say that as background. And I also say I think it is important to remember that this program is $18 billion in debt. Our country is currently borrowing 40 cents on every dollar we spend. And we have a deficit of—or a debt—of $14 trillion. I think that the size and scope of this program necessarily has to take those two realities into effect.

It is my hope that what we come up with at the end of the day is something that minimizes the risk to the taxpayer and the cost to the taxpayer. It is my hope that we can shift as much of the burden to the homeowner as possible, as much of the burden to the private sector as possible.

But I think it is also important that we remember that, if we really want to try to reduce risk as much as possible, we should not be encouraging people to live in places they should not live. I think that should be said, and those are certainly the principles that guide me.

With all of that said, I would like to get your thoughts on the proposal, the current proposal that we are considering that would expand coverage. We had testimony when you were not able to be with us that suggested that insurance works by numbers.

The more you have, the easier it is to spread the risk. That, obviously, makes sense. And obviously, we want this program to be successful.

But at a time that we have a plan that is $18 billion in the red, how do we justify offering additional coverage for loss of business and for, I think it was contents, home contents?

Can you talk a little bit about that? What is your opinion about whether or not that really makes sense as a part of this program going forward?

Mr. FUGATE. The short-term answer is if you are selling more product and you are bringing in more revenue, it may help the existing debt. But what is the long-term exposure? I think this is the balance that we really need as a foundation of the reauthorization going forward.

I believe it is in the interest of the taxpayer to determine what is the level of risk we should subsidize, but then determine what should be done not to encourage more growth and development without mitigating these effects, or find ourselves with greater exposure that is not really distributing.

I think as long as you are writing flood insurance policies, and the only people buying them are those who are perceived to have the highest risk, you have not distributed the risk at all. You have merely added to that.

And again, it may give you some short-term benefit if you are not paying claims out. But if you are not charging a high enough rate, or somehow leveraging that risk across a much larger geographical area, I do not see what we have done other than just continue to incrementally grow the exposure to the program.

But I do think it comes back to, when we looked at the Flood Insurance Program at the beginning, it was to cover the mortgages. Now we are looking at business interruption and additional living expense coverage. I am not saying this is bad.

But I am saying there is a point at which you have to look at, are we really increasing the amount of people participating? Yet if they are in the same geographical area with the same risk as the existing policies, did we distribute that risk and offset that increase?

Mr. HURT. So, it sounds like you do not have a clear answer.

Mr. FUGATE. What I tend to find is that what may benefit one group may penalize another group. And if you look at your premise that the U.S. taxpayer is ultimately backing this program, is this putting more exposure to the U.S. taxpayer, keeping it neutral or reducing it?

I would suggest we would need to come back and actuarially look at that and look at that risk before we gave an answer.

But I think, if your premise is we should not be increasing the risk to U.S. taxpayers, we would need to study that closely and not just look at additional revenues or coverages, but say, does that increase the risk, decrease the risk, or is it still neutral to the overall risk to the taxpayer?

Mr. HURT. Great. And then, I just have a few moments remaining. But let me ask you about the reinsurance.

It is my understanding that, in the past, the program has been authorized to purchase reinsurance. We have not. Why not?

It seems to me that would be a very important part of the future success of this program, if we try to make it successful and have the private sector support it as much as possible.

Mr. FUGATE. I would agree. That is why we looked at the pilot provisions, to look at both how would we do reinsurance, how would—because this would be—essentially, we would use our funds that we collect to buy reinsurance on an annual basis.

What is the level we need to carry? How do we make that work? Again, these would be funds, once expended, we would not have any return on that investment other than the protection it gave us for that calendar year of whatever we purchased. And what is the best mix to buy?

The other area we wanted to look at was, is there a way to incentivize the private sector to begin writing some or additional policies and do a multi-peril, versus just doing their standard policies and then having to have a separate flood insurance policy to go with it.

Mr. HURT. Thank you. My time has expired.

Chairwoman BIGGERT. Thank you.

The gentleman from Missouri, Mr. Cleaver, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Thanks for being here, Mr. Fugate.

During the 1990s, when I served as mayor of Kansas City, my political enemies conspired to bring about two 500-year floods. Kansas City, as you may know, is almost a city that lives with water all around it. Some of it is a comprehensive levee system around the city. And I am not sure that we have had full recovery.

But on page 5 in your testimony, in the 4th paragraph, you talk about how the 2-year extension provides more time for the affected communities to upgrade or mitigate flood control.

I can tell you experientially that is not sufficient, particularly when you consider the fact that we do not have earmarks anymore, which do not add one penny to the deficit or to the budget, and people have been falsely sending out information that is inaccurate.

So, we are unable to direct money, which is the constitutional responsibility of Congress, to projects that are in desperate need. And then, when you add onto that the reality of today, which is that most municipalities are in dire straits, like most States and like the Federal Government, I do not know how in the world we are going to be able to address these issues in a 2-year period.

The Corps of Engineers, which we normally would direct money to, to deal with these projects, is almost doing nothing now, because there is no money available to do these projects.

So, do you think that your agency needs to reconsider this 2-year extension period?

Mr. FUGATE. There is a two-part answer to this, and I think it gets to an issue that you raised, and other Members have raised.

And looking at what we call the provisionally accredited levees, and the 2-year timeframe that we will look at those levees, what we are really talking about is there are levees that actually meet the standards. We just need to get the data to support it. That is part one.

And generally within 2 years, we can get that information. The problem we have is that those levees that would not meet that standard cannot be accredited without significant work. And I think this goes to the infrastructure issue and the funding issue of how we bring levees up to these standards.

Previously, FEMA had taken kind of a binary approach. If you had an accredited levee, then we would afford you the protection in the special high-risk area and put you into what we call "Zone X," which would show the levees protect you, and you are not required to buy flood insurance.

If that levee was not accredited, it was a zero. It did not matter that there was a levee there. It did not matter that it may provide some protection. It was just zero.

We have been asked by both the House and the Senate to look at this. We have made a decision that we are going to work—we think there is the ability to take the existing levees as they are and determine what level of protection they offer, versus merely taking a position that, unless they are accredited, they do not exist, and do not factor in what protection existing levees may have.

This will allow us to give a truer accounting of the existing infrastructure and what those impacts would be, and map according to that, versus saying, until all your levees are fully accredited, we are not going to recognize that they offer protection to some degree.

So, this will be a technical process we will go through at first to see how we will ultimately do that.

But it is our goal to move from only accredited levees being mapped, to levees being mapped based upon the level of protection they offer, with accredited levees providing protection against a 1 percent annual chance of flood or greater. But we will account for existing levees and what that protection is in determining what areas would be in the special flood hazard area and what would not.

Mr. CLEAVER. Is that policy in place today?

Mr. FUGATE. We have responded back to the letter saying we are doing that. We are currently doing the technical reviews of how we will determine that level of protection in the engineering.

It will increase the cost of mapping, in many cases double to what the previous cost was. But it will give a truer accounting of existing levee infrastructure that may not be accredited, but would better identify protection in communities that will require longer lead times to repair or improve those levees.

Mr. CLEAVER. Just keep in mind that when the snow started melting up in the Dakotas, and start—where the Missouri snakes its way down, all the way into the State of Missouri and meets with the Mississippi and the Kaw, that is not a—that is probably 30 or 40 days away.

And, it is a rare spring that we do not have a flood in Missouri. So, it is a pressing problem.

I have one other question, so I need to go on.

Chairwoman BIGGERT. The gentleman's time has expired. Sorry.

Mr. CLEAVER. Thank you.

Chairwoman BIGGERT. The gentleman from Illinois, Mr. Dold, is recognized.

Mr. DOLD. Thank you, Madam Chairwoman.

And I want to thank Administrator Fugate for taking the time to be with us today, and I certainly want to thank you for your service to our Nation, and especially your efforts to monitor and assist with the tragic situation going on in Japan.

I do have just a couple of questions, maybe more than a couple, but I may only get to a few.

With the program carrying significant debt, as you had outlined earlier in your testimony, has FEMA actually taken the maximum allowable premium increases allowed by law?

Mr. FUGATE. For those that were not actuarially based, we were given the authority to increase those a certain percentage each year, but I think that is currently at 10 percent. And looking at being able to accelerate that process is one of the things I believe the draft bill is looking at.

For many people, again, this is, how quickly do you phase in some of these changes, because of the financial impact. Currently, I think the maximum premium increase allowed is 10 percent. I think in your draft bill, you are looking at a higher percentage increase to get those policies quicker to the actuarial rate that we would charge to a policyholder.

Mr. DOLD. Sure. And my question just simply is, has, traditionally, FEMA taken the maximum allowable premium increase?

Mr. FUGATE. Those policies, we normally increase to the 10 percent cap to get them to the actuarial rate. But that is the cap that we can move them to right now.

Mr. DOLD. Okay. And obviously, our goal is that we want to make sure we can—part of our goal is that we want to make sure people are covered. And we want to make sure that we take some of the burden off of the government and the taxpayer, and put more of it onto the private sector.

And in order to do that, the premiums are going to have to rise. I think you have outlined what that balance is going to be for the taxpayer, for the homeowner in those areas.

Now, the other thing is, I like the idea of allowing policy owners to make installment payments for premiums. But I am also concerned that installment payments could also result in adverse selection with policy owners paying premiums only during the perceived high-risk seasons, while letting policies lapse during times where it is perceived to be low-risk seasons.

In that case, FEMA would receive only about half of the premiums they are currently receiving right now.

Are you concerned that installment payments could negatively impact the program's finances? And what can FEMA do to eliminate this adverse selection possibility?

Mr. FUGATE. I know you have more questions. I am going to try to be short.

If I have an escrow account, my insurance and taxes, and all these things, are paid out annually. But if I am personally buying my insurance, the ability to make quarterly payments, I think is critical for somebody who gets that large bill one time a year.

I think we have to just make it clear, though. The rules have to say, you buy insurance a year ahead. So, your quarterly payments, if you stop, not only do you not get to come back in the program, you owe us money, because we covered you for the whole year.

I think this is the way, when you buy car insurance or anything else where you do monthly payments, you do not buy it that month. You buy it at 6 months or 12 months, and you are paying for the full bill. So, if you do not make those payments, you now owe the U.S. taxpayers money back, because you were sold that insurance policy for the full year.

I think that is where the rules have to come back to, that you are not buying it by quarter. You are buying it at a year with installment plans. If you fail to make those payments, you are in arrears to the taxpayers. And there has to be a penalty about how you get back into the program until you satisfy your debt.

Mr. DOLD. Is there an enforcement mechanism that you are thinking of? I like the penalty. Does that mean that you are going to push that off? To whom?

Mr. FUGATE. That would—

Mr. DOLD. Or how is that going to be enforced?

Mr. FUGATE. Traditionally, the way we would look at this program—and we go to the quarterly basis, as I believe the draft legislation looks at—we would make it so that, when you buy the policy, you are buying a year's worth of policy.

If you fail to make those payments, you will go in arrears. We are going to send you a bill. If you don't pay that, we turn those over to the Treasury for collection.

And then we would look at what the rules would say about where you would be able to re-enter that program. Would you have any probation, additional costs? Would you be at higher risk for the penalty of payment?

I think it would be contingent upon, again, our traditional—we do not necessarily collect debt, but we do turn over debt to the Treasury to collect. And I would say, we are selling you a year policy. If you don't make those payments, you owe the taxpayer the money back.

Mr. DOLD. Administrator Fugate, the GAO says that the program is not actuarially sound by design. Does the program reserve for losses like the private insurers do? And has the program ever reserved for losses?

Mr. FUGATE. In the beginning, it was not really envisioned that there would be any funds built up to absorb disasters. Congress over time has allowed some to be built up. But with the existing debt, we are not able to really maintain a large reservoir of funds.

It was, I think, a decision that we are going to subsidize some risk. But I think the unintended consequence is that risk kept growing, not going down.

And so, I think this is where we have to come back and look at the reauthorization, how do we determine what is the level that taxpayers should subsidize versus what the homeowners should be required to protect, and make sure they can protect their mortgages and their investment.

Mr. DOLD. I thank the Administrator. My time has expired.

Chairwoman BIGGERT. Thank you, Mr. Dold.

Mr. Stivers is recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman.

I appreciate the Administrator being here today, and I appreciate your comments on the draft bill. I think you did a great job, and Mr. Dold was just asking about this, of talking about the real adverse selection that is in our national flood insurance today.

And one of the comments that you made, I look back at the portion of the bill that allows you to do private risk management initiatives, and I have a couple of questions that will make me wonder if that will work.

So, you have risk-based pricing today. What is the lowest amount in the very low-risk area that somebody would pay for flood insurance, on average? Two hundred bucks a year? Three hundred?

Mr. FUGATE. Yes, it is a couple hundred dollars. It depends upon the amount of coverage. But it is, if you are in what we call preferred risk outside of the flood zone, it is, depending upon the size of the home and the amount of coverage, a couple hundred dollars.

And so, the idea of privatization is, would there be any—

Mr. STIVERS. Yes, I am getting there. But so, I think the average homeowner pays about $2,000 a year in home insurance.

My question to you is, would you—and I can tell that it is authorized in this bill—but would you be willing to work with some private insurance companies who might be interested in selling a wrap-around insurance product that includes flood- and water-related risk, and then reinsure their risk for the flood piece for some portion of that premium, in order to get folks who have less risk in the pool, to try to make the pool a little more standard?

Mr. FUGATE. I do not really know about the reinsurance piece. But I have asked the industry this question, particularly the Write Your Own Companies.

I asked them the hypothetical question, what could we do as the Federal Government—and I think part of this would come from direction from Congress—to incentivize you writing multi-peril policies that include flood insurance? And are there any areas of that risk that you would be willing to look at versus the higher risk where that could still be primarily a Federal role?

One of the—

Mr. STIVERS. But if they take all the risk and all the premium, that does not help your pool.

Mr. FUGATE. No, but in many cases, those are people who are not currently buying flood insurance in the first place.

Mr. STIVERS. Right. But if we are going to save your pool of flood insurance, don't you have to get people—get the lower risks in your pool?

Mr. FUGATE. If that—

Mr. STIVERS. Unless you want to lose money.

Mr. FUGATE. Here is the question that I would ask: If those people do not have insurance, we are going to end up, in many cases, providing disaster assistance dollars.

So, that is where I think we have to see what the trade-offs are. A term used is, do we allow the most favorable policies to go to the private sector, and we retain the most, highest risk? Would that be offset by reductions in disaster assistance costs, because people were not insured against those losses?

Mr. STIVERS. Okay. Great. And on reinsurance, have you ever looked at—because you have had the capacity to do it before. And I missed this question. I think Representative Hurt asked it. My understanding is, the program has not used it traditionally.

Mr. FUGATE. It has not. And I think that is one of the things I am going to have to write a response back to the committee on the history of that, what they have looked and what they saw as obstacles, and what our history has been on looking at that.

Mr. STIVERS. And I hope you will let us know, because I think this bill gives you the authority, as well as studying how it would work. But if there are any obstacles, we want to try to remove those, because it is in the bad years that reinsurance could help reduce your risk exposure, so, things like Rita and Katrina.

Representative Dold already asked about the quarterly payments. And I think that my question to you is, do you feel like you have all the tools to make that work? Because I know a lot of people pay through escrow payments. And do you feel like you have everything you need to make that work?

Mr. FUGATE. We are looking at it. And I think we can report back, if we see any obstacles there.

Part of this has been the reluctance, as was pointed out, to do quarterly payments and risk that people would only buy it when they perceived risk. And I think this would—we would have to come back and see if we need additional authority—

Mr. STIVERS. That goes back to my first statement about who is in the pool. And I would ask you to take a serious look at that, because unless you can get people in the pool who have a lower actual risk, then as long as you only have people who want insurance who are going to lose money, then the fund is always going to lose money.

So, I would ask you to take a look at how we can encourage people to get in the pool who are lower risk, but have some risk, and want to mitigate that risk with insurance.

Thank you. I yield back the balance of my time, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

We are facing votes soon, and we are going to have nine votes. So, we have to get through this really, really fast. I hope that everybody will have an opportunity to have a minute or two.

I am going to yield to—we will leave and not be able to come back—so I will yield to Mr. Sherman, and I hope that you can divide some time and do it quickly.

Mr. SHERMAN. Yes, I represent an area known as a desert. So, why am I concerned with flood insurance? First, I represent Northridge, and I look forward to us building on the idea of Federal involvement in flood insurance to—a role that hopefully—that we can play in earthquake insurance, while at the same time being actuarially sound and not a cost to the Federal Government.

The second reason I care is—and I have been here a long time—every time there is a disaster, we have uninsured people. The uninsured people's Representatives then come to us for emergency appropriations. And how do you vote against an emergency appropriation for uninsured people who have lost their home?

I have one question, and that is, State Farm left the Write Your Own program. FEMA, as I understand it, is administering all those policies.

Do you want to keep administering those policies? Do you have a fair system to transfer those to the private companies that are participating, and in particular, to transfer those in a particular State to a company that is doing flood insurance business in that State?

Mr. FUGATE. My preference would have been for State Farm to have sold its book of business to another Write Your Own Company; however, State Farm Chose not to do that.

I found out the real issue that I am really concerned about is going to be, when we have a big disaster, we all use the same contractors to process a claim. So, where previously we would have one claims adjustor going out doing Write Your Own Companies, we are going to have to send two out: one for the company that wrote the other part of the damages; and one that is going to have to cover the flood. And that is going to put an additional strain on the people who are doing the adjustments.

So, my goal is to explore whether there are contractual or other obstacles to moving the former State Farm policies from the NFIP Direct Side to other Write Your Own Companies, bearing in mind that we must consider the wishes of policyholders.

But it is an issue that I found out the hard way. With asking the questions, hopefully we will know this now.

There is a finite number of adjusters that people use under contract to go out and process a large number of claims. When we do the direct provision of those policies, we double the number of demand for adjustors in those disaster areas.

Mr. SHERMAN. So, your plan is to move these policies to private companies, try to deal with the adjustor issue, and you seem to be nodding. And I am going to yield to the gentleman from Texas.

Mr. GREEN. Thank you for yielding.

And thank you, sir, for appearing today.

Sir, I have two questions. The first has to do with a study. Having lived along the Gulf Coast and Florida, Mississippi, Alabama, Texas, Louisiana—born in Louisiana—the question is, is there a study that gives some intelligence on the economic impact associated with not having flood insurance along those areas—given that the people who live there depend on it, and they do business with the businesses that are in the area—have we had such a study that you are aware of?

Mr. FUGATE. I would have to research it. I know the question in regard to my experiences in Florida is that, without the flood insurance policies, we would have even more people in worse financial shape.

The thing people do not understand is, even if you get a disaster declaration, FEMA assistance does not take care of your mortgage. We only provide a very limited amount of funds, about $30,000 maximum to individuals to help them recover from a disaster.

Obviously, if your home is damaged or destroyed and you do not have flood insurance, you lose the entire equity and investment that you had left in your home.

The other corresponding piece of this is, in those coverage zones where we do not provide flood insurance such as Coastal Barrier Resource Areas, there is a very character of development and sustainability for those vulnerable areas.

Mr. GREEN. Thank you. The second question: Have we sufficiently answered the question that we had to address—Katrina, primarily, is where I became knowledgeable of it—with reference to wind versus water? Did we get that resolved sufficiently?

Mr. FUGATE. I think it is still going to be a challenge, because when you have different perils covered by different policies, there will always be the question: Which did the bulk of the damages? And it is a challenge.

That is why our ability to work with the private sector and find ways to write more policies as multi-peril is a benefit to both the homeowner and to the people involved.

But it will, I think, continue to be a challenge. I think we work diligently with the Write Your Own Companies and with the adjustors to make those determinations.

But when you have a wind storm and massive storm surge, it will oftentimes be a question that, unfortunately, in many cases is being resolved in the court system. Is this flood, or is this wind?

Mr. GREEN. Since we have a bit of time left, mega disasters.

Would you prefer that I yield, Madam Chairwoman?

Chairwoman BIGGERT. Please.

Mr. GREEN. I will do so.

Chairwoman BIGGERT. Thank you so much. We have two members left.

Mr. GREEN. Thank you.

Chairwoman BIGGERT. Mr. Walberg from Michigan, you have 1 minute.

Mr. WALBERG. Thank you, Madam Chairwoman.

In lieu of the time here, if I would ask the chairman and the committee for the opportunity to submit a more extended statement—

Chairwoman BIGGERT. Absolutely.

Mr. WALBERG. —as well as questions.

Chairwoman BIGGERT. And that will be available to all members.

Mr. WALBERG. I appreciate that. And thank you for the opportunity to be here.

Chairwoman BIGGERT. Thank you.

Mr. Palazzo from Mississippi is recognized for 1 minute.

Mr. PALAZZO. Thank you, Madam Chairwoman. And I just appreciate the opportunity to be on this important committee.

As the Representative from Mississippi's 4th Congressional District, the Mississippi Gulf Coast where Katrina hit in 2005, this is extremely important to me. And I urge this committee to consider all of the reforms put forth by Administrator Fugate.

And if I can, I will just skip to one quick question. If we run out of time, I will submit questions for the record.

Is there a coastal wind insurance crisis? And are there solutions that you may have in mind that could actually help solve our coastal insurance crisis?

Mr. FUGATE. Sir, I am from Florida. The answer is, yes. And the second part of it is, I do not know if there has been a good answer yet.

I look at Florida and the unintended consequences of reinsurance and the CAT Fund, and the problems that we see in the exposure as a taxpayer in Florida that I face with that coverage. It is very challenging. I would not recommend the flood model to address it.

Chairwoman BIGGERT. Thank you so much.

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 this, let me thank the Administrator for being here, and I am sorry that we had votes. You have been a great witness, and thank you for your help.

And with that, this hearing is adjourned.

[Whereupon, at 11:26 a.m., the hearing was adjourned.]

# A P P E N D I X

April 1, 2011

"Legislative Proposals to Reform the National Flood Insurance Program, Part II"

Subcommittee on Insurance, Housing and Community Opportunity

Statement of the Honorable Tim Walberg

4/1/11

I am grateful to the Financial Services Subcommittee on Insurance, Housing and Community Opportunity for allowing me to participate in today's hearing, and look forward to receiving testimony from FEMA Administrator Fugate about how Congress should go about assessing flood risk.

The National Flood Insurance Program is more than $18 billion in debt, and Congress must make changes to this program to put it on a path to solvency. I commend Chairman Bachus and Subcommittee Chairwoman Biggert for taking on this challenge, and I am encouraged by Administrator Fugate's willingness to be a part of this solution.

However, I am here today because the process of mapping and remapping areas that are at risk of flooding is broken. Instead of fulfilling its purpose as a program which allows property owners to lessen their risk of expensive flood damage, it has become apparent to me that this program often requires many property owners to buy expensive insurance they may not need. I have heard from a multitude of constituents in south central Michigan who feel they are victims of an unresponsive, poorly implemented government mandate. From properties that fall within the base flood elevation by less than one inch, to communities who have challenged the flood maps with a ninety percent success rate, there is compelling evidence that the current methods FEMA uses to construct these maps are inaccurate, onerous and punitive.

I am interested to hear Administrator Fugate's views on the apparent flaws in the FEMA flood remapping process. In particular, is it fair that property owners in my district and across this country are being required to buy flood insurance when their property does not face a real risk of flooding? Does it make sense to deem property owners guilty until proven innocent by requiring them to individually challenge the new maps? Is there confidence within FEMA that they are producing the most accurate new maps possible?

Again, I appreciate the Committee allowing me to join in this hearing today, and I look forward to hearing Administrator Fugate's testimony.

**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**

**April 1, 2011**

## I. Introduction

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

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

In my testimony today, I will provide a brief history and overview of the NFIP and discuss critical changes FEMA has made to the program over the years. I also plan to discuss the recent efforts of FEMA's NFIP Reform Working Group, which develops policy recommendations for comprehensive NFIP reform for the Secretary of Homeland Security. It is important to note, however, that the Administration has not taken a position on the preferred course of action for NFIP reform and that these are currently draft proposals from the NFIP Reform Working Group. Congress has been a valuable partner in all of our NFIP efforts, and we appreciate your attention to this important matter.

## II. Overview of the National Flood Insurance Program

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

*History of the NFIP*

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

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

The next year, Congress enacted the Disaster Relief Act, which contained several preparedness and mitigation provisions to reduce disaster-related losses. The Flood Mitigation Assistance program (FMA) also dealt with the effort to reduce loss of life and property by lessening the impact of disasters. FMA was created as part of the National Flood Insurance Reform Act of 1994 to reduce NFIP claims. This law established a FMA Grant Program to assist states and communities to develop mitigation plans and implement measures to reduce future flood damages.

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

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

Prior to 2003, more than 70 percent of FEMA's flood maps were at least ten years old. These maps were developed using what is now outdated technology, and more importantly, many maps no longer accurately reflected current flood hazards. Over the last eight years, Congress has provided over $1 billion to update and digitize our nation's flood maps so we better understand the risks that our nation faces from flooding. Since the start of FY 2009, we have been implementing the Risk Mapping, Assessment, and Planning (Risk MAP) program, which not only addresses gaps in flood hazard data, but uses that updated data to form a solid foundation for risk assessment and floodplain management, and to provide state, local, and tribal governments with information needed to mitigate flood-related risks. Risk MAP is introducing new products and services extending beyond the traditional digital flood maps produced in Flood Map Modernization, including visual illustration of flood risk, analysis of the probability of flooding, economic consequences of flooding, and greater public engagement tools. FEMA is increasing its work with officials to help use flood risk data and tools to effectively communicate risk to citizens, and enable communities to enhance their mitigation plans.

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

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

*Scientific Resolution Panels*

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

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

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

*Preferred Risk Policy*

In 2003, with the support of Congress, FEMA began to implement several initiatives to update our flood maps, especially in those areas that are subject to a high risk of flooding. These initiatives include the Flood Map Modernization program (called MapMod), risk mapping, assessment and planning (by way of Risk MAP), and the Provisionally Accredited Levee (PAL) program.

These flood map updating efforts have yielded maps that more accurately calculate the flood risk. As a result of these efforts, many buildings that were previously considered low-risk have been designated as Special Flood Hazard Areas (SFHAs). The flood risk is real and many property owners now find themselves in high-risk areas, and subject to a flood insurance purchase requirement. Notably, approximately the same number of structures have been removed from the SFHAs as have been added as a result of FEMA's updated mapping program.

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

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

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

The NFIP has successfully reduced flood risk across the United States since its inception in 1968. Evidence of its success can be seen in the more than 21,000 participating communities, more than 5.6 million flood insurance policy holders, a modernized flood hazard data inventory, and a suite of incentives driving risk reduction across the nation. Clearly, the program has improved the resistance of existing and new construction to flooding through building standards, and has helped individuals and businesses recover more quickly from flooding through the insurance process. However, after 42 years of program operation, concerns about the program remain.

**III. NFIP Reform Working Group**

After more than a decade of seeking input, identifying issues, and undergoing studies, FEMA believes that the time has come to undertake a critical review of the NFIP. As Members of this Subcommittee and others in Congress consider NFIP reform, the Department of Homeland Security (DHS) and the Administration is prepared to assist those efforts as appropriate.

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

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

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

As part of Phase III, which is ongoing, the NFIP Reform Working Group is reviewing a comprehensive body of work offering a critique of the NFIP, including reports by the Government Accountability Office, the Congressional Research Service and the DHS Office of the Inspector General; testimony before Congressional committees; proceedings of various policy meetings; policy papers published by industry, advocacy and professional associations; and review and analysis of scholarly works. We have been reaching out and coordinating our reform efforts with other federal agencies. One example is through The Federal Interagency Floodplain Management Task Force which is comprised of twelve federal agencies and whose purpose is to promote the health, safety, and welfare of the public by encouraging programs and policies that reduce flood losses and protect the natural environment.

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

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

*Actuarial Soundness and Program Solvency*

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

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

*Mandatory Purchase Requirement, Affordability and Cost*

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

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

*Accuracy of Mapping*

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

*Economic Development and Environmental Protection*

The impact of the NFIP on economic development is another matter of debate among stakeholders. Areas prone to flooding may have unique resource advantages such as proximity to waterborne transport, as well as environmental or recreational value. However, these advantages, which may be revenue positive for a property owner or community in the short term,

[1] Title 42 USC Chapter 50 4001(a)

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

**The Map Review Process**

FEMA provides community officials and citizens several formal and informal opportunities to review and comment on FEMA's findings. FEMA works closely with local officials to obtain community input related to creating a Flood Insurance Rate Map (FIRM) and usually holds public meetings for community officials and other interested parties to ensure accurate study results of local flood hazards.

Once FEMA completes its study, it provides the community with copies of a preliminary FIRM. After a standard review and comment period of 30 days from the release of the preliminary FIRM, FEMA and community officials meet to review the preliminary FIRM. Unless significant technical concerns are raised during that meeting, FEMA begins a 90-day appeal period when required.

*When Citizens become Involved*

Often, FEMA and the community officials jointly present the preliminary FIRM to the community's citizens at an "open house," where the citizens can review both the effective and the preliminary FIRM and speak with FEMA and community officials on how the new map will affect them. Ultimately, the new flood maps and data are the community's, and communicating the changes and effects is a joint effort between FEMA and the community.

In addition to being invited to attend an open house, citizens are also provided an opportunity to provide input into the process during an appeal period. By statute, FEMA provides every community a 90-day appeal period whenever Base (1-percent-annual-chance) Flood Elevations (BFEs) are proposed or revised. For scheduling purposes, and to give interested parties time to review the information, notices of the proposed BFEs are published in a local newspaper on two different dates, usually within a week of each other. The notice is also published in the *Federal Register* and on the FEMA Flood Hazard Mapping site at https://www.floodmaps.fema.gov/fhm/Scripts/bfe_main.asp#1.

The 90-day appeal period starts on the date of the second publication in the local newspaper. During this time, property owners and other citizens in the community have the opportunity to submit technical and/or scientific data to support an appeal of the proposed BFEs. FEMA encourages community officials to advertise these changes to local residents through informational meetings, the community website and other means.

Individuals can request a Letter of Map Amendment (LOMA) or Letter of Map Revision based on Fill (LOMR-F), FEMA's official determination of the location of a structure in relation to the Special Flood Hazard Area (SFHA). This is an official letter that revises FEMA's FIRM where warranted. Property owners can submit site-specific information for their property to FEMA in support of a LOMA/LOMR-F. If the Lowest Adjacent Grade to the structure (the lowest ground touching the structure, including a basement, attached decks, or a garage) is at or above the BFE, FEMA will issue a determination document showing the structure is outside the SFHA.

Individuals can also ask community officials to request a change to the map if it involves an area larger than their property. This is called a Letter of Map Revision. At any time, community officials can submit scientific or technical data to FEMA to support a map revision. All requests for map revisions are submitted through the Chief Executive Officer of the community, because the community must adopt any changes to the FIRM.

FEMA has recently initiated a review of its practices to allow for even more community input into the mapping process. FEMA anticipates that this review and possible changes in the procedures will take place this calendar year.

**The Case of the City of Los Angeles**

The Flood Insurance Rate Map (FIRM) for the City of Los Angeles, dated December 2, 1980, depicted the area behind a railroad embankment in the Park Mesa Heights neighborhood as an unshaded Zone X, indicating that the area was at low flood risk because it was protected by the railroad embankment. Subsequently, FEMA prepared a preliminary version of the Los Angeles countywide Digital Flood Insurance Rate Map (DFIRM), dated November 26, 2007, that depicted the area behind the railroad embankment as Zone A. Zone A designates a high flood risk area called an SFHA, in which the mandatory flood insurance requirements of the National Flood Insurance Program apply. This DFIRM became effective on September 26, 2008, and is used for flood insurance and floodplain management purposes.

*Why Citizens Were Not Alerted*

Because the new DFIRM did not change the 1-percent-annual-chance flood elevations, FEMA did not publish the changes in the *Federal Register* or the local newspaper. On September 23, 2009, a community meeting was held in which FEMA representatives explained the mapping process and the flood insurance implications of the changes for residents and community officials. A Federal requirement to purchase flood insurance applies to structures in SFHAs that carry a mortgage backed by a federally regulated lender or servicer. Therefore, anyone living in this Zone A area who held such a mortgage on their home was then required to purchase flood insurance.

After the effective date, the City obtained 2-foot Light Detection and Ranging (LiDAR) data, which indicated areas of higher ground elevation than the BFE, which was not available when FEMA produced the countywide DFIRM. Using this more accurate elevation data, FEMA initiated a Letter of Map Revision (LOMR) to modify the area behind the railroad embankment. FEMA issued the LOMR because the new data allowed FEMA to reassess the risk in this area, the area behind the embankment is now depicted on the DFIRM as shaded Zone X—an area of moderate flood risk. Mandatory flood insurance is not required in shaded Zone X areas, so the residents are no longer federally mandated to purchase it. However, FEMA encourages all property owners in low- and moderate-risk areas to consider purchasing flood insurance, which is available at reduced rates. FEMA's consumer website, www.floodsmart.gov, contains more information on flood insurance, the cost of flooding, and how to locate an insurance agent.

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