THE NATIONAL FLOOD INSURANCE PROGRAM: REVIEW AND REAUTHORIZATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

APRIL 1, 2003

Printed for the use of the Committee on Financial Services

Serial No. 108–17

U.S. GOVERNMENT PRINTING OFFICE

89–082 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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THE NATIONAL FLOOD INSURANCE PROGRAM: REVIEW AND REAUTHORIZATION

Tuesday, April 1, 2003

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

The subcommittee met, pursuant to call, at 2:06 p.m., in Room 2128, Rayburn House Office Building, Hon. Robert Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Baker, Bereuter, Jones, Miller of California, Tiberi, Harris, Watt, Clay, Miller of North Carolina, and Scott.

Chairman NEY. [Presiding.] This hearing of the Housing and Community Opportunity Subcommittee will come to order. We are here to hear testimony on the National Flood Insurance Program. Also I thank our witnesses obviously for being here today. I know you traveled a long distance to arrive here. This is an important hearing and your testimony will assist us in determining how best to go about reforming and reauthorizing the National Flood Insurance Program.

Floods have been and continue to be one of the most destructive and costly natural hazards to our nation. The National Flood Insurance Program is a valuable tool in addressing the losses incurred throughout this country due to floods. It assures that businesses and families have access to affordable flood insurance that would not be available on the open market. The National Flood Insurance Program was established in 1968 with the passage of the National Flood Insurance Act. Prior to that time, insurance companies generally did not offer coverage for flood disasters because of the high risks that would be involved. Today, almost 20,000 communities participate in the National Flood Insurance Program. More than 90 insurance companies sell and service flood policies. There are approximately 4.4 million policies covering a total of $620 billion.

In order to participate in the program, communities must agree to abide by certain hazard mitigation provisions such as adopting building codes that require new flood plain structures to be protected against flooding or elevated above the 100-year flood plain. As many of you are aware, the NFIP reauthorization was due to expire December 31, 2002. Unfortunately, Congress adjourned

without extending the program. This situation was quickly remedied in the 108th Congress on January 13 of this year. President Bush signed into law a bill to reauthorize the program for one year, retroactive to January 1, 2003. This one-year reauthorization will give us the time necessary to determine how best to go about reforming the existing program.

We are fortunate to have three of our more distinguished members of Congress on our first panel to discuss the proposals they have introduced. Congressmen Bereuter and Blumenauer have introduced H.R. 253, Two Floods And You Are Out Of The Taxpayer's Pocket Act, which authorizes the program until 2007 and makes changes to the program as it relates to repetitive loss properties. Congressmen Bereuter and Blumenauer have a keen interest in reforming this program and we look forward to hearing about their legislation.

Congressman Baker has introduced H.R. 670, the Flood Loss Mitigation Act of 2003, to provide for identification, mitigation and purchase of properties insured under the National Flood Insurance Program that suffer repetitive losses. As a representative from Louisiana, we know that our chairman, Mr. Baker, is no stranger to the issue and we look forward to hearing about the details of his legislation.

I would also like to welcome Anthony Lowe, the administrator of the flood insurance program and Director of the Mitigation Division, along with our other witnesses. We do look forward to your insight and expertise. I would let you know that our ranking member, Ms. Waters, has notified us she will not be able to be with us today. However, without objection, her statement and that of any member will be included in the record. Hearing no objections, it will be included.

With that, I will turn to the gentleman, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

Ms. Waters asked me to be here, because I had asked somebody to substitute for me at a 10 o'clock hearing on a subcommittee that I was the ranking member of, and that person had agreed to do it. I felt like I at least ought to return the favor to somebody. So I am here. She asked me also to be here because she knows that North Carolina has a dog in this fight, and she probably figured I was going to be here listening to the testimony anyway. North Carolina, I think, is maybe the fifth most impacted state by what we are here to deal with today.

I have a statement from Ms. Waters which I will not read, in the interest of time, but will submit for the record under the chairman's unanimous consent request. I look forward to hearing the witnesses, both my colleagues and the witnesses on subsequent panels. I yield back in the interest of time.

Chairman NEY. I thank the gentleman for yielding back. Other opening statements?

Mr. CLAY. Mr. Chairman?

Chairman NEY. Mr. Clay.

Mr. CLAY. I appreciate that the committee will hold hearings on a subject so important to my district and the State of Missouri. My district is in an area that is the watershed of both the Missouri and the Mississippi Rivers, two of the largest river systems in the

United States. Congress passed a the National Flood Insurance Act to identify flood-prone areas, make flood insurance available to property owners and communities enrolled in the program, and to assist and encourage floodplain management and ultimately reduce federal spending for disaster assistance.

In 1993, one of the worst years in the history of Midwest floods, my district suffered from floods both in the city and in the county areas of St. Louis. There was no one left untouched by the devastation that took place. It would be hard to anyone to contemplate what would have happened were not the National Flood Insurance Program already in place. There is a tremendous need for the reauthorization of this program. It is the key to survival of many Missouri businesses and families.

One of the largest issues of this reauthorization is addressing the issue of repetitive lost property—those properties that have experienced two or more losses greater than $1,000 each within a 10-year period. FEMA has identified over 48,000 properties insured under the national flood insurance plan that meet the definition of a repetitive loss property. Of that number, over 10,000 have had flood losses that total over $80 million annually.

Mr. Chairman, I look forward to the discussion of these issues today and I ask unanimous consent to submit my statement to the record.

[The prepared statement of Hon. Wm. Lacy Clay can be found on page 48 in the appendix.]

Chairman NEY. Without objection. I thank the gentleman for his statement.

The gentleman from Georgia, Mr. Scott?

Mr. SCOTT. Chairman Ney, I want to thank you and certainly Ranking Member Waters and Ranking Member Watt, who has so dutifully taken her place. I want to thank you for holding this important hearing today regarding the National Flood Insurance Program. I represent the State of Georgia. We have had one very impactful area in my state recently, and that is in the Albany-Southwest Georgia area, with the Flint River; and also down in the central part of our state with the Ocmulgee River. We have had some very catastrophic situations that took place there.

I want to thank the distinguished panel of witnesses and my colleagues who are working very feverishly on this issue. I certainly support the National Flood Insurance Program because I believe that it provides an important service to people who have had property hit by a natural disaster. However, I recognize that an exceptional group of repetitive loss properties have cost the program a significant share of annual funds. With the budget battles that are currently being waged in the House, we certainly need to find the best ways to target these scarce federal funds. I certainly look forward to hearing about H.R. 253 and H.R. 670 and other recommendations for the reform of the program.

As we move forward, there are some specific issues that I certainly hope we will cover. I am very much concerned about those that are at the lower end of the economic pole, the lower-income occupants in repetitive loss properties, that do not have the ability to just move anywhere or pay for mitigation measures. It is important to find out what can you assure the low-income owner or

renter of properties in regards to these reforms to the program, and what protections can be offered to them. I am also concerned that in some cases mitigation purchase offers may be insufficient to pay off an outstanding balance on mortgages secured by these targeted properties. Is there an appeal? What appeal or what option would a homeowner have to address this inequity?

We are dealing with the most important asset that any family can have, and that is their home. I recognize the importance of that and I also recognize the importance of the budget shortfall we are faced with. This is our challenge.

Thank you, Mr. Chairman. I appreciate it.

Chairman NEY. I thank the gentleman from Georgia.

With that, we will begin with Mr. Baker.

STATEMENT OF HON. RICHARD H. BAKER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Mr. BAKER. Thank you, Mr. Chairman. I appreciate your courtesy in calling this hearing and offering me an opportunity to participate.

This is an unusual issue in that in the former Congress, former member Bentsen, myself, Baker, my good friend from Nebraska, Mr. Bereuter, and Mr. Blumenauer were all active on this subject. It seems the letter "B" and hot water sort of go together, hand in hand. I have not figured it out yet.

We also have quite different perspectives about the validity of the program and its usefulness to the American people. The first thing I would like to address is the question of taxpayer bailout and the access to taxpayer funds in order to make this program operational. We have plotted and make available to the committee a chart which shows over time the line of credit which is utilized by the program to meet needs of those who fall victim to a flooding event. As you may know, we assess a participant in the program a premium. The premium goes into a fund, and depending on the cycle of weather and flooding and events, we can either have a surplus or a deficit in that fund. There is no question that in given years, we have dipped significantly into that line of credit and have in essence a loan from the American taxpayer. To date, this chart goes through the end of 2001, showing about a $700 million surplus on hand in that fund. All funds advanced for the purpose of flood insurance program payments have been repaid with interest. This is one of those rare occasions, as opposed to being a run on the line of taxpayer credit, it actually is a program which has returned money to the program from which it was intended.

It is my judgment that we need to frame the argument in proper perspective. It really is not a run on taxpayer money. However, if we choose to contrast that with the Federal Emergency Management Administration's general disaster relief program, in the year 2001, for example, $3 billion of taxpayer-appropriated dollars were paid out. Now, we all find those appropriations and activities meritorious. No one here is suggesting we do away with FEMA disaster assistance, but keep in mind the flood insurance program has generated repayment of all advances with interest and currently have a surplus. It certainly will run deficits again, as disasters take

their toll, as contrasted with the FEMA appropriations which literally spend billions of dollars from the taxpayer's pocket.

Then when we began to look state by state, I think many would find this of interest—taking, for example, the state of California as one example of participation in the program. They have insurance in force covering about $45 billion in assets. The premiums they collect to cover that $45 billion exposure is $134 million a year—$45 billion coverage; $134 million in premium. The state of Louisiana, by example, has $45 billion of policy in force. We pay $151 million in flood insurance premium. The small state of Louisiana pays $20 million more a year in flood insurance premium than the great state of California, with the same exposure to the fund.

What does this mean? It means we are perhaps more likely to have a flooding event, but we are paying our portion of our risk. If you look to the numbers of individuals who are covered by the program—and just a brief word how it works. Each state has a 100-year flood survey. If you fall within that 100-year plain, you are supposed to be enrolled in the program paying premium appropriate to your flood risk. That is not the case. Of the areas identified within the 100-year flood plain nationally, approximately one-half of the individual properties are enrolled in the flood insurance program. So on its face there appears to me a very readily acceptable solution. Those who are in a flood-prone area should simply pay the premium. On the other hand, if you were involved in an automobile accident more than once, even if you paid your premium, we do not say to you, we are going to take away your car insurance. Neither should we say in the case of a repetitive flood loss, because you flooded more than once, you should lose your coverage.

Why? Well, if I lived downstream in South Louisiana, and I encourage all of you to come because if you have not been down to the great port of Baton Rouge or New Orleans, about two-thirds of this wonderful nation's water goes right by my house. It is a magnificent thing to see. But in most developments, if you buy in a nice dry subdivision, minding your own business, you can live there for a number of years and because of upstream development, either the municipality, the parish or county as you call it, other developers, can change drainage patterns. You have an on-shore wind, a hurricane brewing, a full moon—that has an affect—and you have an upstream development that changes flood patterns, all of a sudden you find yourself with water in your home where it never occurred before. That was not in bad faith. It was by the actions of upstream development over which you have no control.

So what can we do about this? Well, it just so happens I have a bill, as referenced by the chairman, H.R. 670. This establishes a process which I think Mr. Scott in his opening statement would find interesting. It does not say we are going to pass one standard—repetitive loss, dollars lost. It is going to say that when FEMA identifies you as a problem, they have an obligation to notify you and say you are a problem. Then you have a right to a hearing and offers of mitigation. Under the Bereuter proposal, it is two offers of mitigation you must refuse before you are booted out. Under our proposal, it is one. If you refuse mitigation one time, and it is a responsible solution to your problem, you are out of the

program. It does not refer or relate, however, to the number of losses for which you may claim. You can have one bedroom in the house get the carpet wet, and it is a $1,000 event. You could have one event and be $100,000 event. It gives FEMA the responsibility and the authority to do a case-by-case assessment and places within their hands the responsibility to protect the integrity of the program. To me, that makes a great deal of sense.

You are absolutely correct. In many cases, people who live in low-lying areas are not living in the expensive houses. There are people who may have significant debt. There are people who are going to have alternatives to go out or perhaps even enjoy the benefit of home ownership. They may be renters. The devastation is no less. In South Louisiana, we have a rather direct way of saying it: Do not throw Bubba out with the bathwater. We have working families who are paying their flood insurance premiums, who by no fault of their own find themselves in circumstances not of their own choosing.

There is a way to remedy this program. One is to get all who benefit from it paying premiums as we do in Louisiana, and two, is to give FEMA the discretionary authority to get rid of the multiple offenders who are violating the principles on which the program was built, and I support that. Lastly, as Mr. Blumenauer's interest has expressed repeatedly over time, we need to do more in the way of local initiatives and greening the results of a flood mishap. Where we have a property we have identified, let it not go back into commerce. Turn it into green space so we do not repeat the same problems we are correcting.

Finally, communities should be given credit for their own initiatives to reduce flooding where possible. In my own district, we just passed a property tax in some very conservative territory, as a local match with state dollars to build a $160 million drainage structure which is to lower flood elevations in our community by two to six feet, depending on where you live. Where a community is taxing itself to make changes, that ought to be given credit by FEMA.

Thank you, Mr. Chairman, for this time.

[The prepared statement of Hon. Richard H. Baker can be found on page 35 in the appendix.]

Chairman NEY. I thank the gentleman for his testimony.

The gentleman from Nebraska, Mr. Bereuter.

STATEMENT OF HON. DOUG BEREUTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. BEREUTER. Good afternoon, members of the subcommittee. Mr. Chairman, thank you very much for holding this hearing today on this important subject.

In January of this year, Congressman Earl Blumenauer and I introduced the Two Floods And You Are Out Of The Taxpayer's Pocket Act. We introduced similar legislation in both the 106th and 107th Congress, and I have been active with former Congressman Joseph Kennedy since practically my first service on his subcommittee and committee. This bill represents, then, a continuation of a long-term interest in our effort to reduce the extraordinary cost of repetitive losses from the NFIP as administered by FEMA.

At the outset, I would like to thank Mr. Blumenauer for his dedication and devotion to the principles and details of this legislative effort. I also note that during the 106th Congress, FEMA, under the direction of James Lee Witt, was involved in assisting us in drafting our legislation and was supportive of it. Furthermore, I would like to thank my colleague, Richard Baker, who has, of course, just testified, for his effort and concern about the functioning of the NFIP. He brings up a number of good points. We are proud in fact to take into account certain of his concerns, and there are others that should be. I look forward to working with him.

This legislation is very important because, of course, the authorization expires on December 31 of this year. Our legislation would extend the authorization until 2007 and make essential changes to the program as it relates to repetitive loss properties. According to FEMA, as of January 31 of this year, the NFIP program insured over 48,000 repetitive loss properties. Repetitive loss properties are those which have two or more NFIP claims each over $1,000 within a 10-year period, as we are using that term. These properties represent 1 percent of the properties that are currently insured by the NFIP, but in an average loss year they counted for 25 percent of the NFIP flood claim dollars. The NFIP pays out on average more than $200 million annually to address repetitive loss properties.

If enacted, this legislation we offer I think will help turn the tide against the huge costs associated with repetitive loss properties. Twenty-five percent of all current NFIP policies are subsidized by other premium payers, and thus do not pay actuarially sound rates for their coverage. I agree with Mr. Baker that all properties located within the 100-year flood plain should be required to have national flood insurance. However, they should also pay actuarially sound rates, I would contend. A significant number of those subsidized policies are for repetitive loss properties. Moreover, the NFIP has had the unintended effect of helping people stay in areas that are repeatedly flooded, when it would be in their best interest and those of FEMA and other policyholders of NFIP to mitigate the flood vulnerability of these properties, or to move elsewhere.

The legislation authorizes a $400 million increase in the FEMA mitigation grant assistance program over four years, to be used to relocate or elevate properties that have sustained the most repetitive loss flood damage. Furthermore, the legislation addresses the repetitive loss properties in a simple, straightforward manner. The owner of repetitive loss property will be charged the actuarially sound risk-based rate for their national flood insurance policy, if both of two conditions prevail. The first condition is that two or more NFIP claims must have been paid on an individual property, each over $1,000, within a 10-year period of time. By the way, we certainly will look for discussion and consideration of an amount different, higher than $1,000 if that is in fact too low. The definition is different than the one used in our legislation in the 106 and 107th Congress, which included flood insurance claims under that figure, within the definition of a repetitive loss property. This was a response to the concerns brought to us by various members and interests.

Second, the owner of the property must have refused a federally funded buyout or federally funded mitigation measure such as an

elevation of the structure or property. Of course, mitigation offers would be made only when there is a cost effective mitigation option for the property. FEMA has testified in the past that properties which have suffered more repetitive NFIP claims and/or losses will in general be those which are more cost-effective to mitigate. I think it is important to note that this Act will not in any manner deny flood insurance coverage to any interested owner, renter or occupant of a property. That is not the case, but they must pay realistic actuarially sound rates under this legislation.

I co-authored this legislation for numerous reasons. However, the following four reasons are the most significant grounds, I think, for this legislative initiative. First, some policyholders of repetitive loss properties are able to take advantage of and abuse the NFIP by making claim after claim on the same flood-prone properties. Number two, federal taxpayer money will be saved under H.R. 253. Yes, I know that there is a return on it under most conditions, and eventually that may always be the case. That is uncertain. Three, through the policies and practices of the currently constituted NFIP, the Federal government is encouraging development by giving the subsidized flood insurance to these high-risk areas through the excess insurance premiums and costs to other policyholders. And fourth and finally, there is a demographic trend of far more, and a higher percentage of Americans living closer to the United States coastlines and rivers which will, in the absence of reform legislation, result in a greater number of repetitive loss claims.

So laying a few facts on each of these four, I would say the following. According to FEMA, there is a category of 10,000 repetitive loss target properties which meet one of the two definitions. These target properties either have four or more total NFIP losses no matter what their value, or they have had two or three losses, or the cumulative NFIP payments are equal to or greater than the buildings' value. For example, one of the most egregious examples among a great many examples of abuse of the NFIP was a home in Houston, Texas which was valued at $114,480, yet it received $806,591 in flood insurance payments over the last 18 years. These property owners did not do anything wrong. They just exploited the current situation that is there in our flood insurance program.

I think it is important to note that some NFIP repetitive loss policyholders are not intending to abuse the NFIP, but instead are trapped in a cycle of loss after loss, and mitigation is their only solution for their property. In fact, in some repetitive loss properties, the value of a person's home is now less than their mortgage. It is important to note that FEMA is the only willing buyer of many repetitive loss properties. Furthermore, under the NFIP a very large regional cross-shifting of the cost of flood insurance is occurring. The policyholders in non-repetitive loss areas of the country by their higher than appropriate premiums are subsidizing the policyholders in repetitive loss areas of the country. In FEMA's defense, it does not have the congressionally mandated tools to address the costs and the cost shifting caused by these repetitive loss properties, and we attempt to give them those tools in this legislation.

Second, the legislation will save federal taxpayer dollars. According to FEMA, $1.2 billion of the over $12 billion in past NFIP

losses have been funded by general taxpayer funds. While this money has finally been repaid by FEMA to the Department of Treasury—and my colleague points out, with interest—I certainly know of no private insurance company that can long stay in business if it disregards good actuarial practices. American NFIP policyholders and taxpayers are paying the costs for those individuals who choose to live or who have perhaps no option but to live in high flood risk areas and who fail to take prudent mitigation actions. In some cases, they do not have the resources for mitigation. This bill will help to ensure the future solvency of the NFIP, even when the prospect that we are going to have, according to climatologists, many more hurricanes in the upcoming years.

Moreover, this bill will also save substantial taxpayer money in the cost of federal disaster relief assistance, as many properties will be bought out and removed from federal disaster area-prone areas. This bill explicitly provides that many types of federal disaster relief assistance will be not given to the owners of repetitive loss properties, but only if they refuse to accept the mitigation assistance. Third, my support for the legislation is based on the fact that NFIP gives subsidized flood insurance to disaster-prone areas. Many interests, including taxpayers organizations, flood plain managers, and environmental groups, have argued that the NFIP encourages people to live in repeatedly flooding areas. The question needs to be asked whether rebuilding in repetitive loss, high-risk areas is a sensible and economically justified policy. I believe in many cases the answer certainly would be no. The Federal government should not encourage development in even more repetitive loss properties.

Fourth and lastly, the demographic reality is that more and more Americans each year have residential properties along our coasts and rivers. For example, according to the U.S. Census Bureau, within the next 10 years 75 percent of the United States' population will live within 100 miles of the U.S. coastline. Due to this demographic trend, the time is certainly upon us when Congress should change the structure of the NFIP and encourage proper mitigation action. To further illustrate this point, I support this legislation because of a predicted future change in weather patterns. Dr. William Gray, a highly respected professor of atmospheric science at Colorado State University, predicted that over the next few decades the East Coast and the Gulf Coast will be subjected to more frequent and forceful tropical storms, including hurricanes. Due to the number of repetitive loss properties on the coast, additional hurricanes will result in huge numbers of additional claims under NFIP, and of course disaster relief. It is imperative, I think, that the NFIP is changed before the eye of yet another hurricane is upon us.

In summary, I think we need to stop treading through water of repetitive loss after repetitive loss. Passing legislation is the right thing to do at this time. In fact, Congress has delayed far too long in making some obvious reforms to NFIP. We look forward to working with you, Mr. Chairman and members of the subcommittee and the committee, including especially Mr. Baker, in attempting to craft legislation which will serve the purposes of the NFIP, the tax-

payers, and will not result in undue hardship for people that happen to be living in repetitive loss structures.

Thank you very much.

[The prepared statement of Hon. Doug Bereuter can be found on page 41 in the appendix.]

Chairman NEY. I thank the gentleman.

The gentleman, Mr. Blumenauer from Oregon.

STATEMENT OF HON. EARL BLUMENAUER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Mr. BLUMENAUER. Thank you, Mr. Chairman and members. We deeply appreciate the opportunity to testify here today on this critical issue.

I will not bore you with repeating what my colleagues have mentioned. I just want to be clear that I deeply appreciate the leadership that Mr. Bereuter has demonstrated. I feel like I have learned a lot in having a chance to work with him on this legislation. I am intrigued with a number of the points that our colleague Mr. Baker has focused on in terms of some of the unique circumstances that have occurred over time. We must be broad-minded and flexible in dealing with them.

My focus is making sure that the Federal government is a better partner in making our communities more livable, making families safe, healthy and more economically secure, and dealing meaningfully with the water cycle is an important way to meet that responsibility. For too long, the Federal government has tended to treat our precious water resources as if they were mere engineering projects, machines we could adjust, channel, narrow and accelerate without consequence. The results, frankly, have been little short of disastrous. The flood insurance program is an important element that has developed to try and ameliorate this situation. It is a good example of how the Federal government can work with local communities to lessen the impacts that disasters have on people's lives and property.

As we move toward the reauthorization process, it is time for the Federal government to provide better incentives for all involved—individuals, communities and states—to deal in a comprehensive fashion. Part of the problem is that the way the federal flood insurance program is currently constituted actually encourages flood plain development by, reducing the economic risks of living near the water. We have stimulated some of the things that Congressman Baker talks about that actually make the problem worse over time. The administration, to its credit, has identified an important environmental and economic priority to reform the flood insurance program, and they did that from the first day they started work. The 2003 budget aimed to, "reform the National Flood Insurance Program to improve financial performance and transfer greater financial responsibilities to individuals who build in flood-prone areas."

The OMB has argued that for too many years the program has put expenses greater than revenue from insurance premiums that prevent building the long-term reserves necessary for a rational insurance program. As has been mentioned by my colleague Mr. Bereuter, we are facing, no pun intended, the eye of the storm in the

future—demographic changes, change in weather patterns because of global climate change, and changes in development patterns. We are going to see greater and greater catastrophic loss. Already, we have talked about the $1.2 billion that was necessary to shift because there was a shortfall. But there is a greater problem over time. We are dealing with expenses for disaster relief that the Federal government has to pay that are far in excess of that—over $3 billion extra in a typical year. There are other experts here that will talk in terms of how it is actually greater.

We have seen that our specific target properties take too much of the premium dollar. We subsidize people to live in repetitively flooded areas. In order for them to do so, not only does it drain more resources from the program, but everybody else pays a higher insurance premium than would be necessary. Now, Congressman Baker points out, and I agree with him, that you should not take away somebody's car insurance because they have an accident. But the current situation is analogous to taking that proverbial little old lady who drives her car once a week to church without incident, and making her pay more because somebody who is repeatedly in auto accidents actually pays far less—not taking insurance away, but they actually pay less than they should.

Our Act would correct that. It would not deny insurance to anybody, but it would force them to make a choice after repetitive flood loss. They either move, mitigate or "pay the freight." I would suggest that this will save billions of dollars in avoided disaster relief that we have seen every year in the eight years that I have been in Congress. We have had to shell out more money than was budgeted. But it also will protect the people who live in harm's way. We do not do anybody a favor keeping them in the path of repeated floods. Members of this committee know examples in their own states—in Georgia, in North Carolina, in Ohio, in Louisiana, in Texas—where we have seen people die because they live in places where God has repeatedly shown that he does not want them. We do not do them any favors. I am very interested in the suggestions that are being offered by Mr. Baker for ways to provide appeals, to deal with areas of low income and historic districts. I think we can work that problem through, but we do them no favor keeping them in harm's way.

I have seen the example in my own community. In 1996, we had one of the worst floods in the last half-century. I used to be the Portland public works commissioner and was out there in the morning where there was national television coverage as we were trying to sandbag to prevent flooding in our downtown. We had at least three people die. We had 23,000 people in our state that had to be relocated. We had an estimated more than $250 million of loss, not just from flood insurance, but from disaster relief that the Congress voted to provide. After this experience, our community secured a Project Impact designation and leveraged federal money to create more disaster-resistant communities. Our city applied for a community rating system rating, and in 2001 got a class six rating, what was than the seventh-best rating in the country. Since then, our flood plain residents have seen 20 percent reduction in their insurance premiums, and we have seen much less damage from subsequent events.

I look forward to working with you to save taxpayer money, to save lives, improve the environment and deal with people who have legitimate needs. I appreciate your courtesy.

[The prepared statement of Hon. Earl Blumenauer can be found on page 45 in the appendix.]

Chairman NEY. I thank all three members for testifying. I would be curious, and will work with Congressman Baker, with your office—a very fascinating chart of the year-end results, I would like to see some of the analysis of how this happened and how the flow went up and down. It would be interesting.

I do not have any questions. I just have a comment. We had an interesting situation occur, and I think it just fits in with how you craft a bill, how it is carried out—whatever bill it is. But in Powhattan Point, Ohio we had floods down in an area I used to represent in the old district. What ended up happening was the people would move the trailers off when the flood was coming, and then they would move the trailers back—for years. Well, they moved the trailers off one time, and all of a sudden FEMA said you cannot move them back now until you build a 40-foot tall block wall and put the trailers on top of it. I am not talking manufactured housing. I am talking about 25-year-old trailers.

So you have to step in with caution, and say wait a minute. You could kind of look at it technically that those people were twice or ten-times went into a flood area, but actually—this is a unique thing, I know—but still FEMA came in an said, no you cannot do that—build a 40-foot tall structure, put the trailer on top of it. I think there are cases, when you deal with any of this, you have to really think it through. I know this is one isolated case. There are a lot of situations, I think, that cause a lot of interesting debate on how you craft this to work.

Mr. BAKER. Mr. Chairman, I want to take recognition of some of the points my colleagues have made, and say that the example you have just given is the exact opposite of what I am concerned about, where people go buy a trailer before the flood; they wait until it is starting to flood; move the trailer into the flood plain; make the claim and move back out after the water is gone. I think in the example that Mr. Blumenauer gave of the little old lady and the repetitive speeder, I would in this case give FEMA the right to be the cop and not wait on hearings, not wait on offers, not wait on mitigation turn-downs, but empower FEMA to go get the bad guys and throw them out the next morning.

We are not really that far apart. I think the only difference is how we get at the problem people and who has the authority to make those determinations. I just thank the Chairman for his willingness to give us this opportunity.

Chairman NEY. Thank you. I want to thank the members for their testimony.

Mr. BEREUTER. Mr. Chairman, I would ask unanimous consent, as a member of the subcommittee if I may, that Mr. Blumenauer be allowed to come up front and listen to the other testimony under such conditions as you would lay down.

Chairman NEY. Without objection.

Mr. BEREUTER. Thank you.

Chairman NEY. As long as he walks up and does not ride a bicycle up to the front, but that is okay.

[Laughter.]

I support his bicycling efforts, too, by the way.

I call panel two. I want to welcome Mr. Anthony Lowe. Mr. Lowe has been appointed Director of the Mitigation Division of the Emergency Preparedness and Response Directorate in the newly created Department of Homeland Security. He continues to serve as a Federal Insurance Administrator responsible for overseeing the National Flood Insurance Program.

With that, we welcome you, Mr. Lowe.

STATEMENT OF ANTHONY LOWE, MITIGATION DIVISION DIRECTOR AND FEDERAL FLOOD INSURANCE ADMINISTRATOR, EMERGENCY PREPAREDNESS AND RESPONSE DIRECTORATE, DEPARTMENT OF HOMELAND SECURITY

Mr. LOWE. Thank you. Thank you very much, Chairman Ney, Ranking Member Waters, in her absence, Mr. Watt, members of the subcommittee. I am Anthony Lowe, Federal Insurance Administrator and Director of the Mitigation Division of the Emergency Preparedness and Response Directorate of the Department of Homeland Security.

On behalf of the National Flood Insurance Program, the NFIP, we appreciate the invitation to appear today before the Subcommittee on Housing and Community Opportunity. This summer marks the 35th year since Congress first authorized the National Flood Insurance Program. After humble beginnings, the NFIP now stands as the largest single-line property insurer in the United States, with 4.4 million policies in force and $637 billion in insurance coverage. Nearly 20,000 participating communities are managing their flood risk and reducing America's flood damages by an estimated $1 billion each year. Floods are still, however, the most frequent and costly hazard in the nation. So our mission to save lives and property in America continues. It is our goal to make the NFIP a performance-driven, results-oriented program to improve the delivery of hazard identification, mitigation, and flood insurance services across the United States.

In line with the President's management agenda, we are managing the NFIP, as well as all of our mitigation programs, to achieve real results that reduce the risk and provide greater protection. By the end of this fiscal year, our performance objective is that 5,000 more people, 2,200 more structures, and 150 more community infrastructures will be better protected. Toward this end, we are moving to an e-commerce model that will automate the NFIP's business processes to improve delivery of services, while decreasing the total cost to the program along the entire value chain.

In addition, critical to achieving program results is accurate flood-risk information. Accurate flood-hazard data saves money. More importantly, accurate flood-hazard data saves lives. We appreciate Congress appropriating $150 million this fiscal year to help us update and digitize the NFIP flood maps. We are leveraging that investment with our State and local partners to earn even greater value.

Our mitigation programs are also paying off. For example, among our Flood Mitigation Assistance, FMA, projects completed between 1997 and 2002, we found that for every dollar we invested in mitigation, the taxpayer received savings of $2.62 in avoided flood damages. During this period, we leveraged $170 million for federal dollars, and $60 million in State and local cost-shares to return an overall savings to the American taxpayer of $440 million. We cannot put a price tag on what this means in human terms, however—only that our mitigation projects have made thousands of citizens safer from floods and the misery they cause.

Mr. Chairman, besides the obvious success of the program, I am also happy to report that the NFIP is once again debt-free. In June, 2001, Tropical Storm Alison became the program's first $1 billion storm. We had to borrow $660 million from the Treasury to pay for losses that exceeded our reserves. We repaid that debt with interest in October, 2002. Again, our greatest achievement continues to be in the lives we save and in the communities that are safer from flood losses. However, the NFIP has its challenges. Everyone recognizes that repetitive flood loss properties are a national problem. We are paying far too much in claims for just a handful of properties, and there is a painful human face to this problem as well. Far too many people are caught in a desperate cycle of damage-repair-damage with few options for escape. To a degree, the problem of repetitive flood loss properties is an inherited one. Congress structured the NFIP as an agreement between the Federal government and local communities, communities that would adopt and enforce mitigation standards for new construction in their high-risk flood plains. In return, all property owners could purchase flood insurance.

This program was designed so that the owners of existing properties would pay discounted premium rates that do not reflect the full actuarial risk, so as not to be penalized for buying or building in a flood plain before full knowledge of the flood risk was known. Today, we find that almost all repetitive flood loss properties were built before the availability of detailed flood-risk information. Of course, two bills are being considered today by this committee to address the problem of repetitive flood loss properties. I commend the sponsors for their leadership in focusing attention on this national problem and in proposing remedies for people caught in a desperate cycle of repetitive flood losses. While the administration has not taken a position on these bills, we would like to share with the Subcommittee our thoughts on the necessary tools to address the problem of repetitive flood losses in America.

The NFIP's broad definition of two or more flood losses of $1,000 or more helps us identify for analysis our entire universe of insured repetitive flood loss properties—some 48,000 properties. From this broad category, we would like to first target 10,000 of these insured repetitive loss properties for mitigation, relocation, elevation, or acquisition. This target group of properties has four or more flood losses or two or three losses that cumulatively exceed the value of the building. We have paid close to $1 billion in flood insurance claims on these properties since 1980. We need a full set of tools to address this problem. In this connection, resources are clearly necessary. Flexibility is also key in determining the composition of

repetitive loss projects and in defining our highest priority properties. On average, the program identifies 500 to 750 new repetitive flood loss properties each year. There should also be some consequence for a property owner who refuses a mitigation offer to remove himself from harm's way. An actuarial premium or sufficient deductible is in keeping with the intent of this program.

However, we are also cognizant that some property owners do not accept mitigation assistance, especially buyout offers because they cannot afford the cost share. In other cases, there are few alternative living sites in that area. So again, we need flexibility and often creativity to deal with this unique circumstance. Let me give you one example of that creativity. We are piloting a project in Louisiana that involves the demolition and rebuilding or elevation of six severely flood-damaged properties on the repetitive target list. This will give the owner a new home at the cost of an elevation project. A similar pilot is also occurring in Florida. That cost-share in Louisiana is being borne by the State and the parish. In addition, we also need the involvement of State and local governments in the disposition of these properties so that the Federal government does not become the owner of these properties. With these tools, we can achieve the results that are good for the community, the individual property owner, and the NFIP.

Chairman NEY. I want to note the time has expired.

Mr. LOWE. Thank you.

For us to continue to be effective, however, the authorization of the NFIP is important. We appreciate the actions of this committee to reauthorize this program when we had that lapse back in December. Needless to say, the program and its stakeholders would also be happy with the multi-year authorization that has been discussed by one of the bill sponsors.

Again, thank you for the opportunity to testify on behalf of the program and the Department of Homeland Security.

[The prepared statement of Anthony Lowe can be found on page 60 in the appendix.]

Chairman NEY. Thank you, Mr. Lowe. On FEMA's description of repetitive loss properties, there is a threshold of two or more $1,000 events in a 10-year period.

Mr. LOWE. Correct.

Chairman NEY. How was that definition of repetitive loss arrived at?

Mr. LOWE. What we were trying to do was to really define the entire universe of repetitive loss properties so we could further analyze those properties and try to determine what, if anything, we should do. Obviously, we know that we have 48,000 of those properties from that definition. We were also able to determine that $200 million annually was being spent on these properties. Similarly, with the 10,000 properties that we boiled down from the total to develop our repetitive loss target strategy, we know there is an annual loss of $80 million. Again, that comes from our definition. Because we add to those properties every year from 500 to 750, it means we need a flexible definition that will allow us the opportunity to adjust that target group.

There is also another aspect that I am just going to mention very quickly, simply because I have read the transcripts from last year's

hearing—excuse me, the year before last. There are many instances where there is a property on the target list in the community, but there may be other nearby properties that are repetitive loss, but maybe have not had many losses. The community or the State decides, we need to do something about the whole flood plain, and we do not want the blight of a checkerboard effect of both mitigated and unmitigated properties. Therefore, the State or community proposes to actually address the whole area or the whole number of properties in that community. In that instance, again, we want to have the flexibility to be able to meet their need.

Chairman NEY. If you need the flexibility, but the desire to have the $1,000 in the statute, is that correct?

Mr. LOWE. Frankly, I do not think we would at all be opposed to simply publishing a rule as to what the target group would be in any given year.

Chairman NEY. Instead of——

Mr. LOWE. Instead of any particular dollar amount or any particular number. I say that because the flood plain is always changing and that number will always be changing. We are going to learn as we begin to mitigate more and more of these properties as well.

Chairman NEY. The GAO report—I am not sure when it came out—but it identified improving the financial condition of the flood insurance program and it said that it would be a major management challenge to do that, to improve the financial condition. Do you think there are structural changes needed within FEMA in response to the GAO report?

Mr. LOWE. Again, personally, I would disagree with that report. I think the fact that this program has existed as long as it has, and since 1986 has consistently repaid the treasury what it borrowed with interest after certain disasters—I think that indicates in fact a certain amount of actuarial soundness of the program. By the same token, I think we can do a tremendous amount to strengthen this program by dealing with these repetitive loss properties. The older, so-called pr-FIRM properties account for basically a premium shortfall in the program of about $700 million annually. So when you look at that figure, it means we almost never build up a reserve. Our reserve right now is about $112 million. I wish it were the $700 million that one of the congressmen mentioned, but right now it is not. Again, addressing the repetitive loss problem would very significantly help us to increase our reserves and strengthen the soundness of the National Flood Insurance Program.

Chairman NEY. Right now you are free of debt to the U.S. Treasury.

Mr. LOWE. That is correct.

Chairman NEY. This is probably something you cannot predict, but do you have people looking at future trends, and would you anticipate having to come back for appropriations?

Mr. LOWE. Again, we have not had to come back for an appropriation since 1986. I certainly cannot predict the trend, but an average loss year for the NFIP is from about $750 million to about $850 million, which basically means the program can handle that. When losses exceed that amount then the program runs into problems and we have to go to the Treasury to borrow.

Chairman NEY. Questions from the gentleman, Mr. Watt?

Mr. WATT. You obviously want the flood insurance program reauthorized, but I am not clear on what terms you would have it reauthorized. Is the Administration planning to take a position on the bills that have been introduced? And if so, when? And if not, is the Administration planning to come forward with a proposal itself under which it would like this reauthorization to take place?

Mr. LOWE. I appreciate that. The Administration, as I understand it, does not normally take a position on a bill until after it has been reported out of committee. In this instance, what I have tried to do is to highlight for you, really in looking at both of the bills, the tools that we believe are necessary. Certainly, as I mentioned earlier, the multi-year authorization is important, but so are the flexibility in terms of definition and the understanding both bills seem to exemplify as it pertains to the cost share. Those of you who are concerned about people who may not be able to afford to either take advantage of a mitigation offer or to perhaps move elsewhere, this helps address that situation. So I commend the sponsors of both pieces of legislation. In the past, as has been mentioned, we have assisted, for example Congressman Bereuter, in developing that bill.

Mr. WATT. But both of the bills, it seems to me, the central focus of both of the bills is to eliminate repeat users, either through mitigation or through getting them out of the ability to be in the program. What is your attitude toward that?

Mr. LOWE. Again, as I testified, I really believe that much of what we are trying to do is really quite the same. I think we want to get people out of harm's way. I think that is what our mission is. I think that is the purpose of both bills. In that connection, I think that both dealing with actuarial premiums and/or even deductibles in a more realistic way will help provide us the opportunity, whether someone mitigates or not, to be able to address this problem to some extent. Obviously, I have heard a couple of times that somehow this program encourages people to live in the special flood hazard areas, and I am not convinced that is the case. But nevertheless, the purpose of this program, when it was authorized, was that it would in fact offer insurance to anyone. So the only question that we really have is upon what terms.

Mr. WATT. Let me ask this question a little bit more directly, then. Would the Adminstration be happy with a reauthorization either single or multiple years that does not change the program?

Mr. LOWE. Again, we are hopeful in the program end, and I think the administration might have a position later more directly on the tools that are necessary. The history that I understand that this program has had with Congress, has been one of trying to look at this program over many years, to determine the policy tools that are necessary.

Mr. WATT. I do not think you are being responsive to my question, Mr. Lowe.

Mr. LOWE. I know what you are trying to say, but I——

Mr. WATT. I am trying to find out if you want this program changed or not. I guess that is the bottom line. Would you be satisfied with a reauthorization that does not do anything other than reauthorize the existing program, I guess is the question.

Mr. LOWE. Let me put it to you the best way I can. If you reauthorize this program and you do not change it, then the only thing I can do is pretty much what I have tried to do since I have been here. That is to take every single mitigation program we have and try to leverage it against the repetitive loss problem. What have we seen? We have seen that the number of properties that I am able to, and this program is able to mitigate in one year is exceeded by the number of repetitive loss properties that are added. In other words, I can mitigate, let's say, 270 properties in a year, but I am adding to that list from 500 to 750—some are in the target group; some are in the bottom group.

Mr. WATT. So you want more ability to mitigate.

Mr. LOWE. We need more.

Mr. WATT. You want more ability to mitigate.

Mr. LOWE. We need more flexibility.

Mr. WATT. Thank you, Mr. Chairman.

Chairman NEY. I thank the gentleman.

Mr. Bereuter?

Mr. BEREUTER. Thank you, Mr. Chairman. The gentleman from North Carolina asked a very fair question. I would have to reiterate that H.R. 253 does not force anyone out of the NFIP. It simply says if they refuse mitigation after that second flood of certain dimension, then they have to pay actuarially sound rates. You asked a very fair question at the end there, and I will answer for Mr. Lowe, from my perspective. We have toyed around with this legislation and this program long enough, and either we have reforms or I think we have to force a crisis by blocking reauthorization.

I do have a couple of questions for Mr. Lowe. I very much appreciate your testimony and all the agency has done in the past in your successor position as well. What is your estimation of FEMA's due diligence or success in ensuring compliance for mandatory flood insurance programs, with homeowners who have federally insured mortgages? What more could be done?

Mr. LOWE. I think we need to look for ways to do more. Some of what we have been trying to do since I think there was an IG report that raised this issue, is to sync-up our computer system. We would then have a better idea of when people are not complying, after a disaster when they have dropped their flood insurance that they were required to get in order to get assistance after a flood.

Mr. BEREUTER. Do you think we have had proper kind of effort exerted by financial institutions to cooperate in ensuring that in fact there is flood insurance for properties located within a flood plain for which mortgages are insured?

Mr. LOWE. I have no reason to believe that those determinations have been incorrect. By the same token, we have found there seem to be policies that are falling in between the cracks. So we are spending a tremendous amount of our energy to increase our flood insurance policy base, not by necessarily new policies, which we are certainly interested in, but also by retaining existing policies. We are finding that what we are bringing in the front end, we are almost losing the same amount, if you will, out of the back end. That means we are dropping policies, policies that probably still require

flood insurance. So we are trying to address that now in a number of ways, and I certainly can go into more detail if you would like.

Mr. BEREUTER. Mr. Lowe, as you know, the cost to taxpayers comes primarily for disaster assistance. We have larger and larger disaster assistance rolls because we have few disincentives. In fact, we have some real incentives with Federal and other public funds to locate in flood plain areas. But I would ask you a question with respect to Federal lands. There are more than some people might imagine that are within flood plains, and which have residences located upon them. The Association of State Flood Plain Managers recommends charging these properties as well, actuarial rates. Do you agree that this is a good idea? Are these properties causing a drain on the National Flood Insurance Program?

Mr. LOWE. Yes. I think we definitely need to pay attention to those. I suspect it would be a reasonably large, relatively, percentage of our 10,000 or 48,000 list—either one. I think you are going to find a number of Federal properties. We do need to take another look. Again, whether we address it by full actuarial rates or a combination of full actuarial rates and deductibles, I think we have to kind of move and get off the dime. I think in that connection, Congress' help is very helpful, so that the American taxpayers and certainly property owners feel like their concerns have been fully considered before being hit, if you will, with a full actuarial rate or some higher deductible.

Mr. BEREUTER. Thank you very much.

Thank you, Mr. Chairman.

Chairman NEY. I thank the gentleman. Mr. Scott of Georgia?

Mr. SCOTT. Yes, Mr. Lowe, the general thrust of this is the repeaters, the repetitive loss properties. Let me ask you about the mitigation process. I am fascinated to know why these folks repeatedly, consistently put their families and themselves in harm's way. And could it be that in the mitigation process that maybe the amount that is being offered for that purchase is insufficient to cover the balance on the payoff of their mortgage? Are we being fair with these people? I mean, it just seems to me that there has got to be a little bit more to all of this from the standpoint of that person and his family consistently putting himself in harm's way. Could you respond to that, if that is a problem?

Mr. LOWE. Sure. There are a large number of reasons why people refuse mitigation offers. A lot of them have to do with not being able to meet the cost share, and different states have different rules on what that cost share is. Some states or communities can do more; some can do less. The average split is 75 federal, 25 state or local. If that cost is passed on to a property owner, they may or may not be able to come up with it, which may have a tremendous amount to do with whether or not they take advantage of a mitigation offer. There are certainly other considerations as well. Aesthetics sometimes comes up, believe it or not. The impacts in that community on the tax base can have an impact. There are a lot of things that can come up.

One of the questions that I have asked my staff is, what has been the impact of fair market value and mortgages on determinations of whether or not to accept a mitigation offer. What I am finding is that by and large if someone is talking about a first mort-

gage, it is not much of an issue. But if we are talking about a second mortgage, and somebody has a lot of money outstanding, so to speak, it can be more of an issue. Again, I think both bills that we are talking about today go a long ways to deal with that. Again, the example that I gave of the pilot project in Louisiana, which is again also occurring in Florida, both attempt to address this situation where there is inadequate resource, if you will, that a homeowner can bring to bear so that they can get out of a bad situation.

I would also note one other thing. We have just completed a demographic study, and we have another one that is also in the works. We looked at 2.7 million properties in as many ways as we could against our repetitive loss group, both the large group as well as the target group. What we found is that it really is not a low-income problem. There is not a disproportionate number of low-income properties overall in the repetitive loss target group or in the broader group. However, there are some aberrations. The reverse of that is somewhat true, for example, in Louisiana. So that is a very real problem. But again, that is where we have to have the flexibility to be creative.

I think we have the will, and the program has the will. I think we need the support of Congress and we need the flexibility. Again, in terms of mortgages and fair market values, if we have a situation where someone, because of repetitive flood losses is rapidly losing the value of their property, as was suggested, this may be the best offer that they have. But it is going to be a fair offer, and I suspect most people are going to frankly want to get out of a bad situation. They are not going to want to stay there with floors that never dry out and mold in the baseboards and all of those sorts of things. It is just a horrible way to live.

Mr. SCOTT. So you believe that these two measures before us will give you the tools that you need?

Mr. LOWE. I believe so—the flexibility in the definition, the resources, and certainly the reauthorization. Those are really key for us. Most of the other things we can work through. But again, we have the will to do it and to leverage all of our programs in a way that we have never had before. So I really want to take advantage of that.

Chairman NEY. The time of the gentleman has expired.

Mr. Blumenauer? Would you like to ask a question? I thank the gentleman.

I want to thank the witness for his time.

Mr. LOWE. Thank you.

Chairman NEY. The next panel, panel three. I would note there are votes expected within probably the next 15 or 20 minutes, so we will try to adhere strictly to the time clock. That way we can get in the witnesses testimony and the members of course would be able to come back after the vote.

I want to welcome panel three, and we will begin with Chad Berginnis. He is the Flood Plain Management Program Supervisor in the Division of Water with the Ohio Department of Natural Resources. He has coauthored a comprehensive revision of model state flood plain regulations, drawing in part on his previous experience as director of the Perry County Planning Commission. We want to make sure you tell Mr. Speck we said hi. He was the State Senator

that I replaced years ago in Ohio, so he is director of ODNR. Welcome.

Fletcher Willey is the Chairman of the Government Affairs Committee, Flood Insurance Task Force of the Independent Insurance Agents and Brokers of America, an association representing more than half of all the independent insurance agencies in the country. Mr. Willey owns the Willey Agency in Nags Head, North Carolina, and has been in the insurance industry for nearly 30 years.

Gerald Nielsen is from Metairie, Louisiana—Billy Tauzin and Baker can pronounce that better than I can, but I will give it a shot—Metairie, where he has been practicing law in the area of flood insurance. The Nielsen Law Firm handles National Flood Insurance Program related litigation on a national basis, and Mr. Nielsen has been the attorney of record in the majority of all case law in this area.

Rick Willetts is the President and CEO of the Cooperative Bank in Wilmington, North Carolina, a state-chartered commercial bank with assets of $500 million. Today, he is representing America's Community Bankers, an association of banks which originate more than 25 percent of all mortgages in the United States, some of which are for properties in areas of high flood risk.

I want to welcome the panel, and we will begin with Mr. Berginnis.

STATEMENT OF CHAD BERGINNIS, VICE CHAIR, ASSOCIATION OF STATE FLOOD PLAIN MANAGERS

Mr. BERGINNIS. Thank you, Mr. Chairman, and good afternoon.

In June, 1998 and one week into my job as Perry County planner, a flood devastated a small Appalachian village in our county of Corning, Ohio. Within nine months, we developed a hazard mitigation grant program project that included 59 structures. The mitigation options included acquisition, elevation, retrofitting things such as relocating utilities, were the options chosen by participants. One of those participants, Gertrude Kerrigan, who had flood insurance, declined to participate later on because she said I will probably be long gone before the next flood comes. Hazel Cales, who also had flood insurance, was reluctant at first, but later chose to elevate her home. Afterwards, she told the mayor of Corning, I sleep through the night now and my furniture no longer sits on concrete blocks inside of my living room.

These experiences illustrate benefits and social complexities of implementing the National Flood Insurance Program and flood mitigation. After nearly 35 years, the NFIP has been successful at reducing flood losses nationally, however some modifications are necessary to increase this success.

My name is Chad Berginnis, and I represent the Association of State Flood Plain Managers as vice chair. We are an organization that represents over 5,000 people that are mostly State and local officials that deal daily with the National Flood Insurance Program, the flood plain management and mitigation programs. I want to use the balance of my time to discuss repetitive loss, NFIP reauthorization and some future issues of the NFIP.

Repetitive losses are a drain on the flood insurance fund. The association believes that an overall repetitive loss strategy should in-

clude implementing mitigation that achieves measurable results, implementing cost-effective mitigation that is in the best interest of the NFIP, implementing mitigation that is technically feasible, having a sensitivity to low-income homeowners, allowing flexibility in choosing mitigation options, and utility of different mitigation programs. Two ways to implement this type of strategy would be to actually implement a new initiative based on what we believe is a blending of the best elements of H.R. 253 and H.R. 670, and modifying the existing mitigation insurance mechanism, ICC, or increased cost of compliance coverage.

Both H.R. 253 and H.R. 670 have a number of good provisions, including a definition of repetitive loss properties that at least defines the universe of properties to be considered; an appeals mechanism to ensure due process for property owners; funding that is ultimately paid by the flood insurance fund; the charging of actuarial rates on structures if mitigation is refused; and provisions to address structures on property leased from federal entities. Additionally, upon analysis of these bills, the association recommends that the committee should direct FEMA to work with State and local partners to develop procedures for assessing mitigation options. There should be a recognition that for certain properties, subsidized flood insurance is the best mitigation; that FEMA works directly with property owners, but only after the state and community are unwilling to participate; and that the Federal government not become a landowner regardless of the circumstances.

The increased cost of compliance mitigation insurance has not realized its full potential and could be modified to effectively tackle the repetitive loss issues. Currently, ICC collects over $80 million, yet since 1997 under 1,100 claims have been paid, averaging $11,400 per claim. The maximum claim amount allowed will increase from $20,000 to $30,000 this May. The association believes there are two reasons for this underutilization: FEMA's tight interpretation of the statute, and actually some language within the statute itself. We have provided the committee with three pages of recommended changes.

Briefly, I would also like to comment on the reauthorization of the NFIP. The association believes it is reasonable to reauthorize the NFIP on a three-year basis, which reserves the opportunity for congressional oversight. Then I would like to conclude by discussing the future of the NFIP. The Association of State Flood Plain Managers is both excited and apprehensive. The map modernization program and FEMA's effort to partner with State and local communities have been tremendous. However, we are much more apprehensive about proposed changes to existing mitigation programs. The flood mitigation assistance programs was authorized by this committee in 1994, and is funded by flood insurance policyholders. The 2004 administration budget blurs the line between FMA and a new pre-disaster mitigation program. We would urge the committee to express its intent that FMA be independent of this new program.

Our final area of concern is uncertainty associated with FEMA's placement in the Department of Homeland Security. The NFIP is only one of the department's many responsibilities and we hope

that programs like the NFIP continue to get the resources and attention required to face this nation's primary natural hazard.

Chairman NEY. I would want to note to the witness to sum up because the time has expired. Thank you.

Mr. BERGINNIS. Thank you.

The village of Corning and its residents have a more promising future due to the NFIP and FEMA's mitigation programs. The programs work. Let's work together to make these programs even better.

Thank you.

[The prepared statement of Chad Berginnis can be found on page 49 in the appendix.]

Chairman NEY. I want to thank the gentleman. We will move on to our next witness, Mr. Nielsen.

STATEMENT OF GERALD NIELSEN, NIELSEN LAW FIRM, METAIRIE, LA

Mr. NIELSEN. Good afternoon. My name is Gerry Nielsen. I am a lawyer from New Orleans. My job is to go before federal judges, sometimes State Court judges, all over the United States and I attempt to explain to those judges what Congress intends for the National Flood Insurance Program and what FEMA intends. Right now, there is a structural problem that is preventing me from doing that job effectively, and I am bringing that idea to the Congress' attention because the Congress is the only place where I can go to have a jurisdictional statute fixed.

In 1983, Congress amended the jurisdictional statute to provide for exclusive jurisdiction in the federal courts. But ever since then, the claimants have never stopped trying to maneuver these claims back into the State Courts. So it is an incessant, expensive battle. Lately, they have been meeting with some success. The word "claim" in the statute, federal judges are looking at that under removal jurisdiction, which is a very narrow analysis, and saying, well, wait a minute—that word "claim"—you look at that statute; they are just talking about the claims under the policies. I have got no basis for being in federal court for policy issuance, policy underwriting—all of the operations pursuant to which we put the U.S. Treasury at risk. That is the part that agents and companies do. We handle all of that.

So we are having cases falling into the State Court, and we are having an increase of artful pleadings of people changing the kinds of claims they are making to get around your commend of 4072. The biggest problem this creates is agents. Agents are getting sued at a much higher rate, just for forum manipulation. Now, the position of the states is just to the opposite. The state of California and the state of Florida, who have great interest in the program, have both held through their courts—no, we are going to look straight up at Congress' intent; there is no way Congress intended that the jurisdiction of how you put the U.S. Treasury at risk is in the States—50 different sets of State Courts—and federal court jurisdiction is only over how the money goes out the door. So in those two key program states, jurisdiction over any claim is in the federal courts.

The insurance commissioners of the States of Texas, Mississippi, North Carolina and South Carolina are all of accord. They have signed sworn affidavits that are attached to my written testimony stating that they have neither jurisdiction nor regulatory control over anything involving the NFIP. So I have got the federal judges sending me to the State Courts, and I have got the State Courts telling me to be in federal court. My job is to build a uniform body of case law. It is a problem.

I have presented for the committee a proposed revision of the statute which says in essence that any dispute arising out of participation or attempted participation in the program must be in the federal courts. If you pass this statute, what do you get? Three things: One, you get a stoppage of all the legal bills that are being spent in these arguments over jurisdiction; two, you start to get the development of a unified, uniform system and body of case law over all program issues. Then when you get that, you start getting lessened legal bills on all issues all over the map. What do citizens get? A citizen has no interest in their legal dispute being tied up in the courts for three years over where it is supposed to be. My last 10 appearances before appellate courts, seven out of ten of those were discussions of jurisdiction. We never got to the merits. No citizen wants that.

Now, I quickly point out, I am not asking the Congress to in any way restrict anyone's remedies. We are just talking about jurisdiction here. A federal judge can ruin my client's day as easily as a State Court judge. But where that line is drawn between what federal law governs and what State law governs, has to be drawn on a uniform basis across the country so that the deal anyone gets is equal in California as opposed to New Jersey—that it is the same all the way across the country. So if we make clear that the judges that are deciding what the law is for this unified national program are federal judges, we get lower costs; we get uniformity of decision and predictability in the law; and we get efficient litigation.

The states are the ones saying this is what we ought to have, and it is the federal judges who are hamstrung by their own limited jurisdiction under the Constitution, who are now saying otherwise. And no one is saying that the current situation is what Congress intended.

Thank you for hearing me.

[The prepared statement of Gerald Nielsen can be found on page 69 in the appendix.]

Chairman NEY. I thank the gentleman for his testimony.

Mr. Willey?

STATEMENT OF FLETCHER J. WILLEY, GOVERNMENT AFFAIRS COMMITTEE, FLOOD INSURANCE TASK FORCE CHAIR, INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

Mr. WILLEY. Thank you, Mr. Chairman.

I spoke earlier with Congressman Jones in the room, and he wanted me to thank you for sponsoring the bill that renamed the potato to freedom fries.

Chairman NEY. We appreciate that. My relatives in France are not real happy, but we appreciate Walter's support.

[Laughter.]

Mr. WILLEY. Thank you, sir.

My name is Fletcher Willey, and I am speaking today on behalf of the Independent Insurance Agents and Brokers of America. The NFIP provides the only way that homes and businesses can be protected from catastrophic floodwaters. The private insurance industry will not and has not come to the table to provide coverage for this kind of exposure. Although the independent agents and brokers of America have not taken a position on the two bills before us today, it is clear that reforms are necessary to address certain operating losses and to make the NFIP actuarially sound.

We hope that we can work with you on this reform, because our members have the expertise and the experience serving our flood policy holders covering billions of dollars of property. This is just not a professional matter for me. I live on Roanoke Island, in the flood plain along coastal North Carolina, so I have a personal investment on flood protection. Today, we will outline the five principles that the independent agents support for improving the flood program. First, we need to strengthen the building regulations on both new construction and improvements of existing buildings. Experience with the program shows us that only 4 percent of the repetitive loss properties were built when the communities began enforcing elevation requirements. Second, in creased compliance with mandatory flood insurance purchase requirements show that only 25 percent of the flood plain have flood coverage. We propose that all insurance companies need to inform property owners that their homeowners policy does not cover flood damage.

Third, the NFIP should have additional resources for mitigation. This way, the program can take action to prevent future losses. There are two ways to do this: one, buyouts to move the most frequently damaged risk; and grants to elevate the other risky properties. Multiple loss properties account for $200 million per year in claims. These risks are subsidized by everyone else. Four, we need to stop the abuse of the program with multiple claims. Some properties have collected five to six times their full replacement costs from previous claims. Five, we need to require mandatory disclosure of flood claim history so that new buyers will not knowingly buy a known flood risk property.

[The prepared statement of Fletcher J. Willey can be found on page 103 in the appendix.]

Chairman NEY. The time of the gentleman has expired. The reason I want to mention that to say the time, we have about 10 minutes until the vote ends, so if we give the last witness five minutes, and then we will come back—whoever would like to come back. Thank you.

Mr. Willetts?

STATEMENT OF FREDERICK WILLETTS III, PRESIDENT AND CEO, COOPERATIVE BANK, WILMINGTON, NC ON BEHALF OF AMERICA'S COMMUNITY BANKERS

Mr. WILLETTS. Good afternoon, Mr. Chairman, and members of the subcommittee. Thank you for the opportunity to testify today.

My name is Frederick Willetts, III. I am president and CEO of Cooperative Bank in Wilmington, North Carolina. Cooperative Bank is a State-chartered commercial bank with total assets of

$500 million. We operate 20 offices from Virginia Beach, Virginia to Myrtle Beach, South Carolina. I am testifying today as a member of America's Community Bankers. The NFIP is important to every mortgage lender in the United Stats whose lending territory, like mine, includes properties in areas of high flood risk. We and our customers have come to rely on the NFIP as a primary source of affordable flood insurance.

ACB supports attempts by the Federal government to begin stemming the costs associated with repetitive loss properties to taxpayers. These efforts must protect mortgage lenders by giving them advance notice of any actions that would impair the homeowner's ability to repay the mortgage or recoup the value of the property. Also, Congress must clarify that it does not intend to treat as repetitive loss properties those that have experienced losses that are not expected to reoccur. We also commend Congress for expediting NFIP authorization earlier this year. However, ACB believes that any bill to reform the NFIP must extend NFIP authorization for a period of at least four or five years.

ACB supports increased flood insurance premiums under the circumstances identified in H.R. 670 and H.R. 253, as a way of making property owners take additional responsibility to prevent multiple claims. However, legislation should take into account circumstances that might unduly imperil the homeowner, the lender or other affected parties. Very large increases in premiums could impair the property owner's capacity to pay and would likely affect the value and the marketability of their property. Therefore, the mortgage lender should be notified formally of the planned premium increase in advance, and at a time when intervention might still be possible.

A lender's collateral could also be put at great risk by a mitigation buyout offer. Lenders deserve some assurances that any loan secured by a property targeted for demolition will be repaid with the proceeds of the buyout. We recommend that the bills provide for notice to the mortgage lender or servicer of a buyout offer made under the mitigation program. ACB believes it is essential for Congress to clarify that it does not intend to deny flood insurance coverage to properties in broad geographic areas that might experience large numbers of losses as an aberration. For instance, my home region of coastal North Carolina has recently experienced an unusually large number of hurricanes, one of which resulted in a 500-year flood. It would not be practical for FEMA to respond to such circumstances by seeking extensive mitigation or relocation. Entire communities would be affected. Legislation should clarify the expected scope of circumstances under which FEMA might deny, cancel or otherwise change the availability of flood insurance under the bills to avoid such unintended effects.

Again, thank you for the opportunity to testify today. I would be pleased to answer any questions you might have.

[The prepared statement of Frederick Willetts III can be found on page 98 in the appendix.]

Chairman NEY. I thank the gentleman for his testimony. We will break to vote, and then if you could bear with us, I appreciate it, we will return. Thank you.

[Recess.]

Chairman NEY. The committee will come to order. I want to again apologize to the witnesses. We had to go cast a vote. I think we had finished the testimony of the last witness. I would open it up to questions.

Mr. Bereuter?

Mr. BEREUTER. Thank you very much, Mr. Chairman. I appreciate you continuing the question period so we could come back up and vote for that purpose.

Mr. Willey, as an insurance agent, how can we increase compliance with the mandatory purchase requirements for flood insurance? Why is there not a better record at this point?

Mr. WILLEY. Thank you for the question. We would like to see a requirement that insurance companies notify people that they must buy flood insurance from the National Flood Insurance Program, because homeowners policies do not cover flood. We think it is a notification problem. I know that the National Flood Insurance Program is trying to find ways to notify people, but we think the homeowners' carriers should tell people that they need to get a flood policy to be covered for flood.

Mr. BEREUTER. I would like to ask you, Mr. Willetts, maybe you are the best person to start with, at least on this question. How many mortgages, what percentage of mortgages do you think in this country are federally insured or federally backed?

Mr. WILLETTS. Congressman, I would not have a way of estimating that. I would assume that the majority through brokerage arrangements as well as direct loans through banks and thrifts.

Mr. BEREUTER. Do we have a requirement now which applies to the issuance of mortgages that are not federally backed, and the mandate for flood insurance to cover properties that are in the flood plains?

Mr. WILLETTS. I am not aware that that requirement extends beyond federally insured financial institutions, congressman.

Mr. BEREUTER. I think you are right. I could ask any of you to respond to the concern that people may purchase a property for which there has already been two floods that exceed in value $2,000, for example, or $8,000, as the case in our bill. Perhaps in that case the decision has not been made yet about whether or not they are going to accept mitigation when they sell. That is a pending issue. How do we serve adequate notice to the property owner who may be considering purchase of that property?

Mr. WILLETTS. I am not the attorney in the group, but I will attempt to answer that. I think some method of recording, some device at the public record would be perhaps the best way to accomplish that.

Mr. NIELSEN. You could do it through the public record, having something recorded against the property, or on FEMA's Web site, which is quite extensive. You could have publication. One of the problems FEMA seems to have with this is that they are torn between their own objectives and the Privacy Act. Right now, the companies have to enforce various provisions of the policy and need information as to what has happened on prior claims, and FEMA is really torn as to whether or not they are supposed to be giving us that. So in terms of prior claims for U.S. Treasury funds, there should be no claim of privacy. That would seem to me strange, that

if you have made a claim for public funds that is a public record, and there should be a ready source or a list of that information that anybody can get at any time.

Mr. BEREUTER. Mr. Nielsen, I noted your concern about the jurisdictional question, about the money being spent there, and I take that quite seriously. I think, because I recall that you have specific language that you are suggesting in leaving for us to consider. Is that correct?

Mr. NIELSEN. Yes. It is on page 10 of the written testimony.

Mr. BEREUTER. Thank you.

Mr. Willetts, on page two of your testimony you state that any fix should take into account circumstances that might unduly imperil the homeowner of the land or other affected parties. You mention that you support an appeals process similar to that included in the Baker bill that would allow an owner of property to appeal a decision on mitigation. Are there any changes, requirements or stipulations that you would include as a part of the appeal process?

Mr. WILLETTS. Any changes to the requirements?

Mr. BEREUTER. Any changes or stipulation or requirements to that kind of appeals process, to the language in his bill? Do you have any specific suggestions as to how that might be changed or improved?

Mr. WILLETTS. There has been discussion about architectural integrity, for one thing, in altering a building. Obviously, the question we have brought up several times today about sufficient funds to pay off the loan. I would think that the word "practical" is probably too broad a term, but there could be other cases I cannot think of immediately.

Mr. BEREUTER. Mr. Chairman, I know I have the red light, but may I have Mr. Berginnis respond to that question, too?

Chairman NEY. Without objection.

Mr. BEREUTER. Thank you.

Mr. BERGINNIS. I think as far as the appeals process, Congressman Baker raises several points in his proposal regarding things like historic structures. Those could be things handled perhaps in an appellate-type process, as opposed to an exception kind of criteria where you would exempt actually a whole class of structures.

Mr. BEREUTER. Thank you.

Thank you, Mr. Chairman.

Chairman NEY. I would point out to the gentleman, I have really two brief questions. If you would like to continue, I just have two brief questions. It would be up to you.

The first question I would have is for Mr. Berginnis. The Association of Flood Plain Managers supports the introduction of actuarial rates after mitigation is refused, following a second loss. What is your view on someone who has paid several thousand dollars in premiums over the course of many years, only to lose their coverage after a couple of thousand dollar claims?

Mr. BERGINNIS. This is a situation, and again it is a point made in the oral and written testimony, where there needs to be a realization that there could be circumstances where the best mitigation is the continuance of the subsidized flood insurance. I think the example, Mr. Chairman, that you gave is very appropriate to that, where a person has paid a lot of premium over years. They may

have four, five, six claims, each of them $1,000, yet there may not be a cost-effective way to actually do mitigation. And so potentially in that case, continuing subsidized flood insurance would be appropriate.

Chairman NEY. Thank you.

The other question would be for Mr. Willetts. I noted in your testimony it says that to avoid such problems in the future, ACB advocates a multi-year extension of NFIP, authority for a period of at least four to five years. I think Mr. Bereuter's bill has seven, or up to 2007, if I am correct. I just wondered, is the rationale in any way tied to actuarial tables or what is the interest that it would serve to help you better be able to be involved?

Mr. WILLETTS. I think to avoid the potential train wreck that we faced at the beginning of this year.

Chairman NEY. Mr. Bereuter, do you have additional questions?

Mr. BEREUTER. Thank you, Mr. Chairman.

I would like to go back to Mr. Berginnis, if I could, to the discussion you had there with the chairman in response to his question, which is certainly one of the important questions we need to consider. What about that person that really does not want to proceed or is unable to proceed, in their judgment, to accept the mitigation offer? Now, that would be a problem only, wouldn't it, when we do not have 100 percent of the mitigation costs paid for by the Federal government—75 percent, for example, and 25 percent by State or local? Then would you think that regardless of whether or not the person wants the mitigation to go forward, it ought to go forward, since it is not a matter of them not being able to afford it, but simply they choose not to do that and continue to live at a high-risk location without mitigation?

Mr. BERGINNIS. Well, I think—and again there are so many factors involved as far as offers of mitigation—but really the concept that the association supports is that in these repetitive loss situations, that a property might go through an evaluation of cost-effectiveness, making sense to the flood insurance fund, and go through this process to find out if in fact the property itself can be mitigated. I would think that there would probably be limited circumstances where somebody would continue with subsidized flood insurance, but certainly that could be affected by things like cost-sharing, when you are dealing with, for instance, a low-income homeowner. If the mitigation option were to be 100 percent federal, for instance, for those folks, then a reasonable expectation would be that they would be able to accept the mitigation offer.

Certainly, mitigation is not just—we need to have the flexibility to consider all mitigation. It is not just buyouts. It is elevations. It may be doing minor retrofitting. Somebody could have a furnace that has been repetitively damaged in a flood five or six times, and the appropriate mitigation there may be to elevate the furnace unit or relocate it to a higher level, and you have eliminated the insurance, or at least reduced the insurance risk.

Mr. BEREUTER. And wouldn't it be logical to assume that proper management, common sense management on the part of the federal agency would suggest that where mitigation is extraordinarily expensive or not really very realistic, they simply will not make mitigation offers, and therefore this relieves the person from being

struck out by two strikes and you are out, because there are two conditions. One is, there have been two losses at least, which total $1,000 each loss or more, and that an offer be made and refused. In this case, the offer probably we assume would not be made. Isn't that what you would hope out of a common sense kind of application of the federal agency's requirements? I hope.

Mr. BERGINNIS. Yes. And I think that would be reasonable—if it is not cost-effective, an offer would not be made. Then, again, it would just continue to go——

Mr. BEREUTER. It continues to be there. I have one final question, Mr. Chairman. Thank you for your patience.

Mr. Willey, you suggest that an accessible electronic data base of flood losses be created to facilitate disclosure of flood information. Has your organization been in contact with FEMA regarding the creation of such a data base by chance? Are there currently any procedures used to elicit flood information from property sellers, of which you are aware? The latter could be open to any of you, if you know.

Mr. WILLEY. No, sir. I think the problem is that I have understand that the disclosure runs contrary to the privacy law. I might want to refer to my friend.

Mr. NIELSEN. That would be something that Congress could look at, is that all of this is being done with public funds. To say that there is a privacy interest, as I said earlier, seems inconsistent. So if you could relieve FEMA of that problem for the specific purpose of allowing lists on these things to be published, to where anybody could go look at them, then that would alleviate notice problems. Also one of the big problems we have in flood litigation is a failure to inform claim, where you did not tell me. Well, to the Supreme Court, that is strange because the flood program is a law, the policy is a law. But if we are holding back information that might give rise to that type of claim being validated.

Mr. BEREUTER. I appreciate that suggestion. We are going to look at that. It would therefore be due diligence for any financial institution or any lawyer helping a person to purchase to check that list if it is available and publicly so.

Mr. NIELSEN. Correct.

Mr. BEREUTER. Mr. Chairman, thank you very much.

Chairman NEY. I thank you, Mr. Bereuter.

Mr. BEREUTER. Thanks to all the witnesses.

Chairman NEY. I want to thank the witnesses for coming to the Capitol today and for your very helpful testimony. We have a duty to do something with the issue, and as we go through the next several weeks, we want to keep your views in mind. Also I want to note Mr. Bereuter and Mr. Blumenauer have a very well thoughtful crafted, what I would call a base situation to begin with on that bill.

So I appreciate your involvement today and Mr. Blumenauer, who was here, and the rest of the members.

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 place their responses in the record.

With that, the hearing is adjourned.
[Whereupon, at 4:25 p.m., the subcommittee was adjourned.]

A P P E N D I X

April 1, 2003

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Housing and Community Opportunity
The National Flood Insurance Program: Review and Reauthorization
April 1, 2003

Today we are here to discuss the Federal Emergency Management Agency's National Flood Insurance Program, which provides valuable protection for homeowners across the country who live on the nation's floodplains. Though most of these homes have never flooded, the NFIP is an important safeguard with a proven record of success.

In January of this year, Ranking Member Frank and I worked with our counterparts in the Senate to reauthorize the NFIP. Though there are some who wanted a five-year authorization, we opted for a one-year with the intention of studying the problem of costly repetitive loss claims. Congressmen Baker, Bereuter and Blumenauer, who are here to testify in support of the bills they have introduced on this subject, are this Congress' foremost experts on flood insurance. Their dedication to the issue shows a commitment to their constituents and to sound government. I welcome their appearance before us today.

As we examine the proposed legislation in the coming months and prepare to reauthorize the flood insurance program, I look forward to working with our colleagues and with the Administration to address this issue. In light of the nation's troubled economy, the approximately $200 million being spent on an annual basis on repetitive flood loss properties is an unacceptable expense.

It is important to note that the problem of repetitive flood loss properties is one that exists in nearly every one of the fifty states. In my own district, the Blanchard River and Black Fork Creek have caused some homeowners to be flooded more than once. Property owners in flood-prone areas must be responsible for working with their communities and with FEMA to avoid repetitive flood losses. At the same time, we must ensure that the rights of these property owners are protected and that the NFIP is responsive to their needs.

Let me take a moment to welcome the other witnesses we will be hearing from today. In particular, I'd like to extend a special welcome to Chad Berginnis. Mr. Berginnis, the Floodplain Management Program Supervisor for the Ohio Department of Natural Resource's Division of Water, is appearing on behalf of the Association of State Floodplain Managers. I'd like to thank you for the important work you and your colleagues are doing for homeowners in the Fourth District and throughout Ohio, and I look forward to hearing your testimony this afternoon.

Today's hearing will be a valuable step towards reauthorizing the National Flood Insurance Program and eliminating costly repetitive flood losses throughout the United States. Once again, thank you, Chairman Ney, for your leadership on this issue.

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Subcommittee on Housing and Community Opportunity

Hearing on the National Flood Insurance Program
April 1, 2003

Congressman Richard H. Baker
Sixth District, Louisiana

Good afternoon Chairman Ney and members of the subcommittee. I appreciate the opportunity to testify on the reauthorization of the National Flood Insurance Program (NFIP). Quite frankly, flood insurance is important to my constituents and to the state of Louisiana. My state represents one of the largest users of the program with 367,111 policies and $151, 285, 082 of written premium in force. My constituents rely on the NFIP and the program must be continued.

The need for reauthorization presents us with the most viable opportunity in almost ten years to examine the effectiveness of the NFIP and to determine if any reform is necessary. I believe the program should remain largely unchanged, but there is broad consensus that reform is necessary in one area: repetitive loss properties. Around $200 million per year in claims are paid to repetitive loss properties. Out of this $200 million, $80 million is directed to about 10,000 properties, roughly 2,900 of which are located in Louisiana.

The problem has become so severe (FEMA estimates that over 48,000 insured properties have received repetitive claims) that current resources provided the NFIP are not sufficient to address the problem. We must be bold in our thinking and take aggressive action to mitigate or otherwise limit these repetitive losses. However, we must not proceed with reform without regard for the impact our actions will have on homeowners and businesses. After all, the NFIP was created to help our constituents, not punish them.

Basic Problem Defined—Repetitive Loss Properties

Repetitive loss properties are those properties that have flooded twice since 1978 with claims exceeding $1000. As I mentioned before, there are currently over 48,000 such properties that are covered by federal flood insurance. Out of this 48,000, close to 10,000 properties account for $80 million in claims each year with all repetitive loss properties accounting for roughly $200 million in annual losses.

The problem of repetitive loss properties has persisted since the inception of the program due to two main reasons: many of these properties were grandfathered into the program

and FEMA has no resources to aggressively mitigate them. This resource mismatch has proved challenging and indeed, in spite of amendments to the program in 1994 to provide mitigation authority, the situation has improved at best only marginally. Congress needs to give FEMA a broad grant of authority to aggressively mitigate these properties and Congress needs to give the agency the resources necessary to get the job done. I have introduced legislation, both in the 107th and 108th Congress, that I believe achieves both of these goals.

Broad Grant of Authority to FEMA

Under my legislation, H.R. 670, FEMA is given broad discretionary authority to identify and offer mitigation to repetitive loss properties. FEMA is granted the authority to take action against policyholders who refuse an offer of mitigation assistance. Under this provision, FEMA may raise insurance premiums, refuse to renew an existing policy or cancel an existing policy. Most observers, including FEMA, believe the vast majority of individuals that own a repetitive loss property will be eager to accept mitigation. I also believe this to be the case, and anticipate FEMA's need to exercise its new authority will be limited.

While granting FEMA broad authority to address the repetitive loss problem, my legislation also protects policyholders by recognizing that under some circumstances a policyholder may have legitimate reason to refuse a mitigation offer. The circumstances enumerated in my legislation are; 1) if offered a buyout option, the policyholder will not be able to continue in homeownership; 2) if mitigation activities will significantly disrupt or alter culturally and historically significant areas; 3) if flooding is a result of third party development; and 4) if the policyholder purchased the property in good faith reliance on FEMA flood maps. Finally, the legislation protects policyholder interests by creating an appeals process should FEMA take an action the policyholder believes is unjustified.

Making New Resources Available

Granting new authority to aggressively mitigate repetitive loss properties accomplishes little unless FEMA is granted the resources needed to complete the task. The resource

mismatch is so great that FEMA will never be able to mitigate all repetitive loss properties using its current programs at current funding levels. While FEMA receives an annual $20 million appropriation for the Flood Mitigation Assistance program, this amount of funding hardly maintains the status quo. While other programs exist in FEMA's portfolio—the Hazard Assistance Program and the Pre-Disaster Assistance Program—these programs are not specifically targeted at repetitive loss properties which further dilutes resources. Additional funds specifically earmarked for repetitive loss properties are necessary if a long-term solution to the problem is to be implemented.

Under current law, FEMA is authorized to borrow from the U.S. Treasury to cover premium shortfalls in years with large insurable events. Since 1986, FEMA has repaid this debt with premium income, not appropriated funds. This means that only those individuals participating in the NFIP bear the financial burden for repaying this debt. FEMA's record of repayment is exemplary. The agency's debt has been paid off on time and with interest each time its borrowing authority was exercised. My legislation proposes to build on this relationship by authorizing FEMA to borrow up to $300 million from the U.S. Treasury for the purposes of mitigating repetitive loss properties.

According to FEMA records, the agency has identified all repetitive loss properties and maintains an actuarial study estimating future claims anticipated for each property. My legislation will require FEMA to mitigate the properties for which the greatest losses are anticipated with the borrowed funds. After mitigation of a property is complete, FEMA will direct their program cost savings to other mitigation efforts. Through such reinvestment, FEMA will be able to use premium income, not appropriations, to prevent future losses. This protects the program, protects taxpayers and will help thousands of families trapped in repetitive loss properties.

Reform Must Protect the Program and Policyholders

The central focus of any reform considered to the NFIP must be to do no harm to the program. The NFIP enjoys broad acceptance by the American people and the public has

come to rely on federal flood insurance to play a key role in disaster recovery. The program should continue to be available to those in need and premiums should not be set so high as to price homeowners and businesses out of the program. Every dollar of premium paid—even from a repetitive loss property—offsets local, state and federal government disaster response costs. Furthermore, mortgages on homes in flood hazard areas are required by federal law to carry flood insurance. If this insurance is not available or is prohibitively expensive, the program could actually do harm to the progress our nation has made in the area of homeownership.

Reform efforts must also take into account the efforts of local communities to reduce flood losses in their area. In my district, we are beginning construction on one of the largest flood control projects in the state. Known as the Comite River Diversion Canal, this flood control project will lower flood levels in the targeted flood hazard area by one to six feet. A significant portion of the $160 million necessary to construct the canal was raised by a property tax that local residents approved. My constituents are willing to pay higher taxes to fund this flood control project. I believe this contribution and commitment should be recognized. And, I believe that any community that takes action on its own to address local flooding should receive consideration from FEMA and the NFIP.

Finally, we must not overlook the amount of premium income that states—even those with a large number of repetitive loss properties—contribute to the program. As I mentioned earlier, Louisiana has about 2,900 targeted repetitive loss properties, but my state also contributes $151, 285, 082 in premium income to the NFIP. In fact, the five states with the top identified repetitive loss properties currently have over $1 billion of written premium in force. Congress, and this committee, must not be misled into thinking that flood prone communities around our nation are making no contribution to the NFIP or to flood control efforts. This is simply not the case.

Mr. Chairman, it is obvious that the NFIP faces a crisis in the repetitive loss problem. However, in our efforts to address the issue, we must above all else protect the goodwill

and trust our constituents have placed in the program. Americans rely on federal flood insurance and this insurance must remain available at a reasonable price to the largest portion of our population. If we can create a partnership between FEMA and repetitive loss property owners, Congress can help families stay in the program and Congress can help families prevent additional flood losses.

I believe Congress and this committee are up to the task of reforming the NFIP to resolve the repetitive loss problem. I look forward to working diligently with all interested members to accomplish our common goals.

Witness Testimony Housing Subcommittee

Two Floods and You Are Out of the Taxpayer's Pocket Act

April 1, 2003

Congressman Doug Bereuter

Good Afternoon. Thank you Mr. Chairman for having this Subcommittee hearing on the subject of the National Flood Insurance Program (NFIP). In January of this year, Congressman Earl Blumenauer (D-OR) and I reintroduced the "Two Floods and You Are Out of the Taxpayer's Pocket Act (H.R. 253)." We introduced similar versions of this legislation, in both the 106th and 107th Congresses. This bill represents a continuation of my long-term interest and my past efforts in the House to reduce the extraordinary costs of repetitive losses from the NFIP as administered by Federal Emergency Management Agency (FEMA).

At the outset, I would like to thank Mr. Blumenauer for his dedication and devotion to the principles and details of this legislative effort. I would also note that during the 106th Congress, FEMA, under the direction of Director James Lee Witt, was involved in assisting us in drafting our legislation and was supportive of our legislation. Furthermore, I would also like to extend my appreciation to Congressman Richard Baker (R-LA), who is also testifying today, for his efforts and concern about the functioning of the NFIP. I look forward to working with Mr. Baker on the subject of repetitive loss properties.

This legislation is very important because the authorization of the NFIP expires on December 31, 2003. Our legislation would extend the authorization of the NFIP until 2007 and make essential changes to the program as it relates to repetitive loss properties.

According to FEMA, as of January 31, 2003, the NFIP program insured over 48,000 repetitive loss properties. Repetitive loss properties are those which have two or more NFIP claims each over $1000 within a 10-year period. These properties represent 1% of the properties that are currently insured by the NFIP, but, in an average loss year, they account for 25% of the NFIP flood claim dollars. The NFIP pays out, on average, more than $200 million annually to address repetitive loss properties.

If enacted, the "Two Floods and You Are Out of the Taxpayer's Pocket Act" will help turn the tide against the huge costs associated with repetitive loss properties. 25% all current NFIP policies are subsidized and thus do not pay actuarial rate for their coverage. A significant number of these subsidized policies are for repetitive loss properties. Moreover, the NFIP has had the unintended effect of helping people stay in areas which are repeatedly flooded when it would be in their long-term best interests and those of FEMA and other policyholders of the NFIP to mitigate the flood vulnerability of these properties or move elsewhere.

This legislation, H.R. 253, authorizes a $400 million increase in the FEMA Mitigation grant assistance program over four years to be used to relocate or elevate properties that have sustained the most repetitive loss flood damage. Furthermore, this legislation addresses repetitive loss property in a simple, straightforward manner; the owner of a repetitive loss

property will be charged the actuarial, risk-based rates for their national flood insurance policy if two conditions prevail.

The first condition is that two or more NFIP claims must have been paid on an individual property, each over $1,000, within a 10-year time period. This definition is different than the one used in our legislation in the 106th and 107th Congresses which included flood insurance claims under $1000 within the definition of a repetitive loss property. This was in response to the concerns brought to us, by various Members and interests.

Second, the owner of the property must have refused a federally funded buyout or federally funded mitigation measure, such as an elevation of the structure or property. Of course, mitigation offers would be made only when there is a cost-effective mitigation option for the property. FEMA has testified in the past that properties which have suffered more repetitive NFIP claims and/or losses will in general be those which are more cost-effective to mitigate. It is important to note that this Act will not in any manner deny national flood insurance coverage to any interested owner, renter, or occupant of a property, but they must pay realistic actuarially-sound rates.

I have co-authored H.R. 253 for numerous reasons; however, the following reasons are the most significant grounds for this legislative initiative:

1. Some policyholders of repetitive loss properties are able to take advantage of and abuse the NFIP by making claim after claim on the same flood-prone properties;

2. Federal taxpayer money will be saved under H.R. 253;

3. Through the policies and practices of the currently constituted NFIP, the Federal Government is encouraging development by giving subsidized flood insurance to these high-risk areas through the excess insurance premiums and costs to other policyholders; and

4. There is a demographic trend of far more and a higher percentage of Americans living closer to United States coastlines which will in the absence of reform legislation result in a greater number of repetitive loss claims.

Today, I would like to use this opportunity to explain, in greater detail, these four reasons for my support of H.R. 253. First, I support this legislation due to fact that policyholders of the NFIP are not paying the actuarial rate for their flood insurance. According to FEMA, there is a category of 10,000 repetitive loss target properties which meet one of the two definitions. These target properties either have had 4 or more total NFIP losses no matter their value or they have had 2 or 3 losses where the cumulative NFIP payments are equal to or greater than the building's value. For example, one of the most egregious examples among a great many examples of abuse of the NFIP was a home in Houston, Texas, which was valued at $114,480, yet it has received $806,591 in flood insurance payments over the last 18 years.

It is important to note that some NFIP repetitive loss policyholders are not intending to abuse the NFIP, but instead are trapped in a cycle of loss after loss and mitigation is their only solution for this property. In fact, in some repetitive loss properties, the value of a person's home is now less than their mortgage. It is important to note that FEMA is the only willing buyer of many repetitive loss properties.

Furthermore, under the NFIP, a very large regional cross-shifting of the cost of flood insurance is occurring; the policyholders in non-repetitive loss areas of the country by their higher than appropriate premiums are subsidizing the policyholders in repetitive loss areas of the country. In FEMA's defense, it does not have the congressionally mandated tools to address the costs and cost-shifting caused by their repetitive loss property. The "Two Floods and You Are Out of the Taxpayer's Pocket Act" will give FEMA the authoritative tools to gradually reduce the number of repetitive loss properties and to stop this cost-shifting to other NFIP policy-holders.

Second, our legislation, H.R. 253, will save Federal taxpayer dollars. According to FEMA, $1.2 billion of the over $12 billion in past NFIP Flood losses has been funded by general taxpayer funds. While this money has finally been repaid by FEMA to the Department of the Treasury, I certainly know of no private insurance company that can long stay in business if it disregards good actuarial practices. American NFIP policyholders and taxpayers are paying the costs for those individuals who choose to live in high flood risk areas and who fail to take the prudent mitigation actions. This bill will help to ensure the future solvency of the NFIP and reduce the future need for the NFIP to borrow from the Treasury.

Moreover, this bill will also save substantial taxpayer money in the costs of Federal disaster relief assistance as many properties will be bought out, and removed from Federal disaster-aid prone areas. This bill, H.R. 253, explicitly provides that many types of Federal disaster relief assistance will not be given to the owners of repetitive loss properties -- but only if they refuse to accept mitigation assistance.

Third, my support for this legislation is based on the fact that the NFIP gives subsidized flood insurance to disaster prone areas. Many interests, including taxpayer organizations, floodplain managers, and environmental groups, have argued that the NFIP encourages people to live in repeatedly flooded areas. The question needs to be asked whether rebuilding in repetitive loss high risk areas is a sensible and economically justified policy? I believe in many cases the answer certainly will be "no." The Federal Government should not encourage development of even more repetitive loss properties.

Fourth and lastly, the demographic reality is that more and more Americans each year have residential properties along our coasts and rivers. For example, according to the United States Census Bureau, within the next 10 years, 75% of the United States population will live within 100 miles of the U.S. coastline. Due to this demographic trend, the time is certainly upon us when Congress should change the structure of the NFIP and encourage proper mitigation action.

To further illustrate this point, I support H.R. 253 because of a predicted future change in weather patterns. Dr. William Gray, a highly respected Professor of Atmospheric Science at Colorado State University, predicted that over the next few decades the East Coast and Gulf Coast will be subject to more frequent and forceful tropical storms, including hurricanes. Due to the number of repetitive loss properties on the coasts, additional hurricanes will result in huge numbers and amounts of additional claims under the NFIP. It is imperative that the NFIP is changed before the eye of yet another hurricane is upon us.

In summary, the title of the legislation is "Two Floods and You Are Out of the Taxpayer's Pocket Act." We need to stop treading through the water of repetitive loss after repetitive loss. Passing this legislation is the right thing to do at the right time. In fact, Congress has delayed far too long in making the obvious reforms needed in the NFIP. I look forward to the other testimony today and to working with the Housing Subcommittee on the reform of the National Flood Insurance Program this year. Thank you.

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Testimony of Congressman Earl Blumenauer

Hearing on the National Flood Insurance Program
And FEMA's Repetitive Loss Mitigation Strategy

Subcommittee on Housing and Community Opportunity,
Financial Services Committee

Tuesday, April 1, 2003

I would like to thank Chairman Ney and Ranking Member Waters for holding today's hearing. The Committee's hearings on this subject during the last two Congresses were very helpful in highlighting the importance of the issue and the impact of the National Flood Insurance Program (NFIP) on government spending. This year the issue takes on an even greater importance as the NFIP is set to expire in December.

I came to Congress committed to making the Federal Government a better partner in the livability of our communities – ensuring that our families are safe, healthy, and economically secure. Much attention is given to air quality and traffic congestion as negative indicators of livability. I think that the water cycle is likely to be even more important in the years ahead. In the United States, we have spent years treating our precious water resources as if they were mere engineering projects – machines that we could adjust, channel, narrow, and accelerate without consequence. The results are little short of disastrous – and they could get worse. All of this takes place against the backdrop of global pollution and climate change.

The National Flood Insurance Program is crucial to the lives of many people across the country, and is a good example of how the federal government can work with local communities to lessen the impact that disasters have on people's lives and property. However, as we look towards reauthorizing this program this year, I believe it is time for the federal government to step up and do a better job of providing incentives for individuals, communities, and states to act responsibly.

Unfortunately, our national disaster policy – including the dominant structural model for floodplain and flood management – has a number of problems. Despite spending more than $38 billion attempting to control flooding between 1960 and 2000, flood losses during that time still averaged about $8 billion per year, six times what they were before all of that money was spent. This problem is going to get worse: as more retirees and other Americans flock to coastal states, the number who live in hurricane alleys is

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expected to double. It is estimated that by 2025, 75% of our nation's population will live in coastal communities. Natural forces will continue to confound our best engineering efforts.

In some cases, federal flood control policy actually encourages floodplain development by financing the construction and repair of levees and underwriting the risk of flooding. As environmental and taxpayer organizations have argued for years, one major impact of the NFIP has been to encourage construction in high-risk flood plains and coastal areas. By reducing the economic risks of living near the water, the Federal Government has stimulated development there. Ironically, the federal government is aiding and abetting patterns of living that are unsustainable and draining significant resources. Much of the flooding occurs in places where weak zoning laws have allowed developers to drain wetlands and build in floodplains.

President Bush recognized many of the problems of the NFIP in his budget for FY 2003. His budget aimed to "Reform the National Flood Insurance Program to improve financial performance and transfer greater financial responsibility to individuals who build in flood prone areas." He indicated that in some years the program has expenses greater than its revenue from insurance premiums and that this prevents it from building long-term reserves to handle the costs of flood insurance. About 25% of the policyholders pay only a portion of the cost of their premiums, with the Federal Treasury and other policyholders subsidizing the rest. This results in a premium shortfall of about $700 million annually. The program is currently self supporting from premium income. However, in the 1980s federal taxpayers were asked to bail out the program to the tune of $1.2 billion when the income from the low premiums were not enough to cover the flood claims. The chances of this happening again are high.

One particular problem with the NFIP, which I am glad that we are discussing here today, is the burden of repetitively flooded properties. President Bush has noted in his budget that these properties account for a significant share of the program's losses. In fact, FEMA reports that just 1% of the properties account for 25% of NFIP flood loss dollars.

I have often cited a house in Houston, Texas, as perhaps the worst example of the flaws in the NFIP. Valued at $114,000, it was the subject of more than 16 claims between 1989 and 1995, bringing in a total of more than $800,000. I understand from FEMA that this particular property has finally been bought out, but I also understand that there are currently 10,000 properties like this in the flood insurance program that have had 4 or more losses or 2 or 3 losses where the cumulative flood insurance claim payments are equal to or greater than the building's value.

Subsidizing people to live in repetitively flooded areas does not make sense. It is bad for the federal taxpayer, bad for the environment, and bad for the families that are continually placed in harm's way. The majority of these repetitively flooded properties are primary residences.

In an attempt to tackle some of these problems, Rep. Bereuter and I have introduced this year, and for the past two Congresses, the "Two Floods and You're Out of the Taxpayer's Pocket Act." The purpose of this legislation is to avoid many of the injuries, deaths, and damages before they occur, and give property owners the option of moving to a less hazardous area.

Our approach reforms the NFIP to give people a choice. If an individual has made two or more claims to the NFIP over $1000 in 10 years, he may choose to continue to live in a hazardous area and accept the actuarial, risk-based cost of flood insurance for living there; or he may receive federal aid to move or elevate his property out of harm's way. This Act would never deny national flood insurance coverage to any interested owner, renter, or occupant of a property.

This bill has a number of benefits:

- One of the most compelling benefits of this bill from my standpoint is that it will save the federal government millions of dollars in avoided flood damages. FEMA reports that mitigation and building standards already in place have resulted in over $1 billion annually in reduced flood losses. Our bill will significantly increase these savings by increasing funding for the mitigation grant assistance program.
- Perhaps more importantly, it will move people out of harm's way and discourage newcomers from moving there. This bill will save lives by moving people to higher ground.
- Finally, this bill will significantly benefit the environment. If property-owners choose to sell their properties to FEMA and move, the land will convert to open-space. History teaches us again and again that non-structural approaches to flood control, such as voluntary buyouts and restoration of natural floodplains, are much often more effective in controlling floods than structural approaches. I would like to see an even greater emphasis on community planning as a way to reduce future flood damage.

In closing, I appreciate this opportunity to re-examine our national flood insurance policy. I look forward to hearing the testimony of the other witnesses. I also look forward to continuing to work with my colleagues Mr. Bereuter and Mr. Baker to pass a reauthorization of the National Flood Insurance Program this year that finally deals with the problems of repetitively flooded properties.

STATEMENT OF THE HONORABLE WM. LACY CLAY
Before the

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

"National Flood Insurance Program"

April 1, 2003

Good afternoon Mr. Chairman and Members of the Committee. I am in deep appreciation that the committee will hold hearings on a subject so important to my District and the state of Missouri. My district is an area that is in the watershed of both the Missouri and Mississippi rivers, two of the largest river systems in the United States.

Congress passed the National Flood Insurance Act to identify flood prone areas, make flood insurance available to property owners in communities enrolled in the program, to assist and encourage flood plain management, and ultimately reduce federal spending for disaster assistance.

In 1993, one of the worst years in the history of Midwest floods, my district suffered from floods both in the city and in the county areas. There was no one left untouched by the devastation that took place. It would be horrifying to contemplate what would have happened were not the National Flood Insurance Program already in place. There is a tremendous need for the reauthorization of this program that is the key to survival of many Missouri businesses and families.

One of the largest issues of this reauthorization is addressing the issue of "repetitive loss properties", those properties that have experienced two or more losses greater than $1,000 each within a ten year period. FEMA has identified over 48,000 properties insured under the National Flood Insurance Plan that meet the definition of a repetitive loss property. Of that number over 10,000 have had flood losses that total over $80 million annually.

Mr. Chairman I look forward to the discussion of these issues today. I ask unanimous consent to submit my statement to the record.

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TESTIMONY

Association of State Floodplain Managers, Inc.

before the
Subcommittee on Housing and Community Opportunities
House Committee on Financial Services

NFIP Oversight and Repetitive Loss Strategy
H.R. 253 and H.R. 670

presented by
Chad Berginnis, CFM, ASFPM Vice Chair
State of Ohio

April 1, 2003

INTRODUCTION

The Association of State Floodplain Managers, Inc., and its 16 State Chapters represent over 5,000 state and local officials and other professionals who are engaged in all aspects of floodplain management and hazard mitigation, including management, engineering, planning, community development, hydrology, forecasting, emergency response, water resources, and insurance. All 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 programs and working to achieve effectiveness in meeting our shared objectives. Many of our members are designated by their governors to coordinate the National Flood Insurance Program. For more information on the Association, please visit http://www.floods.org.

The ASFPM is enthusiastic that the Committee has put consideration of NFIP reforms high on its agenda for the 108th Congress. We are particularly appreciative of the time and attention that Representatives Bereuter and Blumenauer, and Representative Baker, have collectively paid to the issue of repetitive claims against the National Flood Insurance Program and how measures to reduce those claims can be effected.

Thank you for inviting us to offer our views on a number of general matters related to the NFIP, and on the proposals set forth in H.R. 253 and H.R. 670. The following testimony addresses:

1. The NFIP's Repetitive Losses & Changes Needed
2. Existing Mitigation Insurance Mechanism Requires Reform
3. Matters Related to Reauthorization of the NFIP
4. The NFIP and the Department of Homeland Security
5. The Importance of Continued Federal-State Partnerships
6. The Role of the States in FEMA's Map Modernization Initiative
7. Existing Mitigation Program are Being Jeopardized
8. The Effectiveness and Value of the National Flood Insurance Program and FEMA's Flood Mitigation Programs

1. ADDRESSING THE NFIP'S REPETITIVE LOSSES & CHANGES NEEDED

It is important to put the repetitive loss problem in context. While the exact number is not known, it is estimated that over 9 to 11 million buildings are in the areas we call special flood hazard areas that are shown on FEMA's Flood Insurance Rate Maps. About 4 million buildings both in and out of the floodplain are insured today (up from only 2 million just 9 years ago). Of those, about 40,000 are on FEMA's list of repetitively flooded properties. Nearly 10,000 have experienced four or more losses, or two or more losses which combine to exceed the building's value as reported on the flood insurance policy. This means that initially we are focusing attention on one-quarter of one percent of the insured buildings. But the impact is huge, since that small fraction accounts for on the order of 40% of the NFIP's losses since 1978.

We have all seen or heard of the homes that have been characterized in a way that implies the owners are abusing federal flood insurance. While there may be a number of egregious offenders, for the most part the repetitive loss business owners and homeowners can hardly be thought of as

taking advantage of the program. If your family or someone you know has been flooded, even if only 6" above the carpet, then you understand the personal and economic impact that results. Plus, flood insurance does not cover all costs, given the deductible and list of items not covered.

GENERAL COMMENTS ON REPETITIVE LOSS STRATEGIES

It must be clear that the initiative is to fund only mitigation measures for specific properties that achieve results that are **cost effective and in the best interests of the NFIP.** This will preclude imposing a "solution" that will insufficiently avoid damages over the anticipated life of the mitigation measure. For mitigation projects, benefits are defined as "damages avoided if the project is implemented." Under this requirement, a building that has sustained several low-dollar value claims will rarely have a cost-effective solution. If there is a cost effective mitigation measure, such as elevation-in-place, a property owner should be encouraged to participate. If the owner declines an offer, the rest of the policyholders should not have to bear the continued claims against the Fund.

It must be clear that the initiative is to fund only projects that are **technically feasible.** There will be properties for which the typical approaches (acquisition or elevation) will not be possible. For example there are many situations where low-cost measures can have significant benefits, such as relocating utilities out of a basement. For non-residential structures, of which there are many near the top of FEMA's list of repetitive loss properties, a range of retrofit floodproofing options may yield significant benefits. It is important that we reduce damages and recognize that some mitigation that achieves that goal is better than doing nothing simply because a complete solution isn't feasible.

FEMA's other mitigation programs and tool can be brought to bear to support mitigation of repetitive losses (please see section 7 for brief comments on how the grant programs have been affected by recent actions). A new initiative should be designed to work in concert with existing programs to maximize effectiveness. These existing programs and tools include:

- Mitigation insurance (Increased Cost of Compliance) which is described below and is ripe for revisions;
- The Flood Mitigation Assistance Program authorized by this Committee as part of the NFIP Reform Act of 1994 as Section 1366;
- The Nationwide Pre-Disaster Competitive Mitigation Program, authorized in 2000 and funded in FY2003 to create a nation-wide competitive grant program; and
- The post-disaster Hazard Mitigation Grant Program authorized by the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

OBJECTIVES OF A REPETITIVE LOSS STRATEGY

A Repetitive Loss strategy should be viewed as a **cost containment** initiative for the NFIP that will benefit every current and future policyholder. It makes sense for the policy holders to invest in cost effective measures that will, in short order, reduce the pressure to raise the rates. In recent years, the cost of insurance has gone up close to 10% each year. For the average policy, that's on the order of $40 a year. If that trend can be changed, then every policyholder will benefit. We can think of it this way: a program to mitigate less than 1 percent of the insured properties could save 4 million people over $160 million dollars in premiums <u>each year</u>.

Another long-term benefit of a repetitive loss strategy is that, without a doubt, it will **reduce federal disaster assistance,** although it may take longer to see the effects. When the pressure to raise the rates is reduced, more people will see that flood insurance is a "good buy" as the cost comes more in line with their perceived risk. This is the single most significant way to reduce that part of the federal disaster dollar that supports uninsured individuals, families, and businesses after the President declares a flood disaster. For flood-related disasters declared between 1989 and 1998, FEMA paid over $3 billion for Individual and Family Grants (does not include SBA and other agencies, or the effects of the casualty loss deduction on tax income). For this reason, ASFPM believes it is appropriate for a repetitive loss strategy to increase funding for the Flood Mitigation Assistance Program and to modify the insurance mechanism called Increased Cost of Compliance. ASFPM's proposal has been submitted to the Subcommittee.

Low-income homeowners and renters occupy many of the houses in the nation's repetitive loss areas. Often the low-income occupant simply does not have the financial ability to move elsewhere or to pay for mitigation measures. It is far too simplistic to assume that every owner is able to make a rational choice based on cost alone. In those instances where grants or offers are made to low-income homeowners and renters, we are concerned that it be done in a carefully crafted manner that networks with existing housing programs. It is vital that there be recognition that if a specific property cannot be mitigated in a manner that is both technically feasible and cost effective to the NFIP, then the best mitigation is continued subsidized insurance, as anticipated by Congress when the NFIP was created in 1968. While the NFIP policy base as a whole would continue to subsidize the risk (which is the fundamental premise of insurance), at least the owner continues to purchase flood insurance and contributes to his or her own recovery, thus not burdening the U.S. taxpayer. The cross subsidy for these particular structures is comparatively small.

FEMA has determined that **non-residential buildings** make up a significant portion of the small group that has had multiple losses that appear to exceed the value of the building. Buyout of such properties is unlikely for many reasons. Non-residential buildings encompass a wide variety of structure types, thus a range of retrofit floodproofing options must be examined. ASFPM recommends that FEMA examine how handling these properties will differ from normal procedures used for residential property.

SPECIFIC COMMENTS ON H.R. 253 AND H.R. 670

ASFPM offers the following general comments and highlighted areas of concern regarding the two bills introduced to address the repetitive loss issue:

1. We understand the desire to define how many losses of a certain value should constitute a "repetitive loss." We believe the definition is for convenience only, to put some boundary on the set of buildings that will be examined. There is nothing that would require FEMA to make a mitigation offer to each and every building that falls under that definition. Indeed, if it is clear that the initiative is intended to focus on those properties for which there are cost-effective measures that are in the best interests of the NFIP, then it becomes less important exactly how the term is defined.
2. Cost-effective and in the best interests of the NFIP are not simply terms of art. We have become experienced at evaluating cost effectiveness. Based on years of working with these terms under other programs, ASFPM is convinced that properties that have received multiple, low-dollar value claims are highly unlikely to have cost-effective solutions. On the other hand, owners of such properties may very well be interested in effective solutions.

3. Mitigation measures that may be considered for any specific property are likely to be those with which we have become familiar: elevation-in-place, retrofit floodproofing, physical relocation, demolish/rebuild, and acquisition (if there is an appropriate recipient of the restricted deed).

4. We urge the Committee to direct FEMA to work with state and local partners to develop procedures for assessing feasible mitigation measures and approaching and working with property owners to encourage participation. Because so much will depend on how property owners are approached and the array of options, we suggest that FEMA be required to report and demonstrate its methods to the Committee prior to implementation.

5. It must be clear that there will be properties for which retention of insurance will be the best "mitigation." While low-level property damage may continue and small claims will continue to be paid, by purchasing flood insurance the owner is contributing to the cost of recovery and does not become a burden on the U.S. taxpayer.

6. ASFPM does not support explicit exemptions for properties in certain categories. We believe that many of those owners may welcome financial assistance. Therefore, rather than exempt properties, we urge that FEMA be required to bring additional assistance to the table. For example, under current grant programs, if the buyout offer is insufficient to purchase comparable housing in the same area, as much as $22,500 in supplemental housing assistance may be added to the offer. Many historic properties may be retrofit in ways that preserve their historic designation. Rather than consign such properties to continued flooding, ASFPM urges consideration of flexibility to mitigate to the extent practicable (which may involve elevation of utilities, use of flood-resistant materials).

7. Exempting properties for which flooding is associated with a third-party is problematic. On the one hand, we are pleased to see Congressional recognition that flood levels are not static, and that increasing flood levels are often associated with increased development. That is much of the reason for the continued increase in flood damages in the nation. On the other hand, applying such an exemption would not reduce flooding and could prevent assistance to property owners who are seeking help. We think the issue is better addressed by the other options in these bills.

8. ASFPM believes that including an appeals mechanism will be an important part to assure due process for property owners. However, we are concerned that the focus on exemptions and unwilling property owners may result in overlooking one of the objectives – helping people who flood frequently. We believe that most people will accept a reasonable offer for feasible measures. We do recognize that a few may refuse. Therefore, we urge that the Committee require FEMA to reconsider preliminary rules and comments that were received on this matter.

9. ASFPM endorses giving FEMA the ability to work directly with a property owner, but only if the state and community are unwilling or unable to participate. However, we are concerned about FEMA's capacity to handle this time-consuming effort. To address this, we urge consideration defining grant recipients to include non-profit, non-governmental organizations that have compatible missions, such as community development and housing organizations or other non-profits to receive and manage grants.

10. ASFPM strongly opposes the concept that the federal government become the landowner, regardless of any qualifying circumstances. Many buyout properties are lots interspersed in established neighborhoods – it is entirely out of the question that FEMA would be able to maintain such lots in a manner that prevents them from becoming eyesores or health risks

due to trash and vermin. Prior to the Reform Act of 1994, FEMA implemented a program to acquire properties, called Section 1362. It was found to be burdened by a multitude of problems, not the least of which was that FEMA took title to lands which were then transferred fee simple to communities. ASFPM does not feel that this is a viable alternative, and urges reconsideration of any provision that would involve federal ownership of land, no matter how briefly.

11. Both bills lack sufficient detail regarding how the mitigation assistance will be provided. ASFPM believes that the first and best approach is through the local jurisdiction. However, other mitigation grant programs require a 25% non-federal match (even the Flood Mitigation Assistance Program that is funded by NFIP policyholder funds, not general funds). It is unclear if the Committee expects the owner to contribute funds, for example if the proposed mitigation measure is elevation-in-place or retrofit floodproofing.

12. The two bills propose different mechanisms to fund the activities. Regardless of the mechanism, every single person who obtains a flood insurance policy will be contributing to the funding. This is acceptable because of the anticipated benefit in terms of reduced pressures to raise rates. However, we urge the Committee to more fully examine the impact on the policyholder. Whether rates are increased to pay back funds borrowed from the Treasury or whether the federal policy fee is increased, the impact on policyholders should be clear. We suggest that the Committee establish a specific sunset so that a decision can be made as to whether it is necessary to continue the additional increase.

13. ASFPM urges that the Committee phase in funding, but we recommend that it is best to reverse the order proposed in H.R. 670, i.e., provide a smaller amount in the initial years while policies and procedures are being established. FEMA has taken a long time to get some programs up and running and this one needs to be very carefully crafted and coordinated with state partners before rolling out. Rather than rush forward, we must be assured that the procedures will foster policyholder participation.

14. With regard to consequences for property owners who refuse a mitigation offer, ASFPM suggests that rather than deny insurance it is better to authorize the NFIP to rate the policy using actuarial rates. The logic of also denying disaster assistance may seem sound, but it can be difficult to administer, especially in the immediate aftermath of a large flood when delivery of Individual Assistance is expedited.

15. ASFPM supports charging actuarial rates if a mitigation offer is refused, as long as the property owner is fully informed and fully understands the consequences of refusing an offer, and as long as the offer is for a reasonable, feasible, and cost effective measure. But those are important caveats. An owner should not be penalized if the only measure that will protect the home is not cost effective and if the owner (especially the low income owner) is required to bear a large share of the costs. ASFPM believes there are some people for whom the best mitigation is the financial protection provided by flood insurance.

16. H.R. 253 has a provision regarding property leased from a federal entity. In most of those circumstances, the land is leased, but the building is owned by the occupant. ASFPM does not object to those pre-FIRM properties continuing to have subsidized rates, but only if the federal landowner plays by the same rules as communities. This will preserve the *quid pro quo* of the NFIP. This can be accomplished by requiring the federal landowner to apply the NFIP's minimum floodplain management standards or by requiring the federal landowner to require building owners to obtain permits from the local jurisdiction.

17. ASFPM request that the new funding be used for projects that primarily address repetitive

loss properties, rather than exclusively for those properties. Community projects, especially acquisitions (buyouts) that lead to compatible reuse and utilization of vacated land, rarely involve only insured properties. A similar qualification was made for the Flood Mitigation Assistance Program (see Report 103-652).

18. It is very important that the amount of funding currently available to states to provide technical assistance under the Flood Mitigation Assistance Program be increased in order to provide the support that communities and property owners will require. ASFPM recommends that the Committee specifically authorize a portion of the added funds be made available to states for technical assistance, in order that the program is effective.

2. EXISTING MITIGATION INSURANCE MECHANISM REQUIRES REFORM

The 1994 Reform Act authorized mitigation coverage as part of the standard flood insurance policy (Sec. 1304(b)). Called ICC or "Increased Cost of Compliance," it was touted by FEMA – and expected by others – to be one of the best tools to effect post-flood mitigation, in part because it is funded by a surcharge on flood insurance policies (up to $75 annually). Unfortunately, those expectations have not come about. Why? ASFPM believes it is because FEMA has tightly interpreted the statute. While we appreciate that initially the agency had no experience on which to base its interpretations, much has been learned in the last five years.

The time has come to make changes so that this self-funded mitigation mechanism can fulfill original Congressional intent. ASFPM has drafted amendments to Sec. 1304(b) to achieve the intended objectives and provided that material for the Committee's consideration and will submit the materials for your consideration. The following is a brief overview of ICC, implementation issues, and recommendations for improvement:

1. Every flood insurance policy on property within a mapped floodplain – even post-FIRM policies, pays something for ICC. The cost ranges from $3 to $75 per year. The upper limit is paid on pre-FIRM buildings and V Zone buildings (where open coast where wave energies and erosion are greatest). It is notable that post-FIRM buildings (built in compliance with the rules) pay for this coverage even though the chances of ever qualifying are slim. Why? Because if ICC was working, then every policyholder would enjoy the benefit of reduced pressure to raise the rates.
2. ICC is a claim, paid only if damage is triggered by a flood event and only if the damage is sufficient to meet one of two triggers. Every community in the NFIP administers what is commonly referred to as "the 50% rule" or substantial damage. If the cost to repair a damaged building to its pre-damage condition exceeds 50% of its market value, then the community's rules require the owner to bring it into compliance. Most commonly, this means the existing building is lifted off its foundation and raised on a new, higher foundation. This substantial damage rule has been in place since early in the program; until ICC was authorized, the owner had to bear the entire cost.
3. Although FEMA has announced an increase of the benefit under ICC to $30,000 (effective May 1, 2003), in actuality, as currently administered this increase does very little to increase funding of eligible mitigation activities. The average ICC payment to support an acquisition project is on the order of $7,000. A small number of ICC payments have been made to support elevations, in part because FEMA has only recently ironed out administrative wrinkles and has begun to require the insurance adjusters to follow specific procedures to help policyholders through the process.

4. ICC can be triggered by "cumulative repetitive loss," which the statute defines as two or more claims in a 10-year period, each of which is at least 25% of the market value of the building. However, because the statute specifically states that compliance is required, FEMA's implementation requires the community to have an ordinance that mirrors that trigger. Very few communities have adopted that ordinance language. The result is that ICC as it is currently authorized is an ineffective tool to address repetitive losses.
5. Sec. 1304(b)(3) is an excellent tool for FEMA to focus on the top tier of repetitive loss properties, especially in communities where there is little interest in seeking a mitigation grant. The provision explicitly authorizes the FEMA Director to pursue mitigation offers for properties for which it is determined that it is cost-effective and in the best interests of the NFIP to achieve compliance. It is our understanding that FEMA has not implemented this, in part because of the statutory constraint that "compliance" is required. FEMA does not impose compliance - that is the purview of the local regulatory authority. ASFPM has recommended an amendment that would eliminate this obstacle and allow FEMA to become proactive.

3. MATTERS RELATED TO REAUTHORIZATION OF THE NFIP

The Association does not consider the NFIP's periodic sunset provision to be an explicit expression of Congressional intent that the program may actually be terminated. It is a convenient mechanism to require periodic attention to the needs of the program. The consequences of short-term lapses have been outlined by others, in particular, the insurance and lending industries that are especially sensitive to this issue. We submit that it is reasonable to reauthorize the NFIP on a 3-year basis, which will preserve the opportunity for oversight on a regular basis.

ASFPM's primary concern is that the wrong message may be conveyed, i.e., that the program's importance does not warrant Congressional commitment, which may have the unintended consequence of weakening state programs. Too many states and communities continue to view the NFIP as a purely federal program, with little or no commitment on their parts. Also, lapses in the NFIP cause an increased workload for state and local floodplain officials as they have to spend a large amount of time and resources answering questions from concerned homeowners, insurance agents, lenders, legislators and reporters.

4. THE NFIP AND THE DEPARTMENT OF HOMELAND SECURITY

The NFIP is only one of many FEMA's responsibilities that are now transferred into the Department of Homeland Security. The Association of State Floodplain Managers, Inc., is very concerned that the NFIP's mission will get overwhelmed by the forces driving DHS. Millions of homes and businesses are located within the Nation's floodplains and development pressures continue. These people are located in areas that, with reasonable scientific certainty, we can say are exposed to a 1% change of flooding in any given year. Every year, areas in nearly every state are flooded, often damaging critical local infrastructure and forcing thousands of people out of their homes. This is a risk that we cannot allow to fall victim just because FEMA is in a new agency.

We appreciate Secretary Tom Ridge's statement made before the House Appropriations Homeland Security Subcommittee last week that FEMA's mission "will not be jeopardized in any way, shape or form." We are particularly encouraged that he specifically mentioned the importance of mitigation in that mission. A major part of FEMA's mission is disaster loss prevention or mitigation. Millions of people, buildings, and public infrastructure facilities are at risk due to natural hazards. Development of mitigation policies and programs is absolutely essential to

controlling the huge costs of natural disasters and will contribute to saving lives and property. Such policies are an important corollary to FEMA's response and recovery capabilities. In fact, mitigation often is accomplished in the immediate aftermath and rebuilding phase following a natural disaster when people's awareness of their risks is high and local and state commitments leverage federal dollars.

States and local jurisdictions know FEMA not only for its disaster response, but for its role in establishing long-term policies that influence new development and redevelopment in high risk areas. FEMA has development regulations, provides federal flood insurance, and coordinates technical assistance through the states to help communities and land owners build in ways that minimize flood damage. FEMA works with building code organizations to incorporate reasonable and cost effective mitigation measures into building codes, and to encourage states and local jurisdictions to adopt those codes in order to remain economically and socially viable by reducing flood losses.

It is important for us to agree that a federal flood insurance program is a vital component in the economic well-being of the Nation. Without the NFIP, trying to bear the rising costs of flood disasters would have catastrophic financial implications for millions of families and businesses and about 19,600 counties, cities, towns and villages across the country. Once we agree on the NFIP's importance, then we can pursue what is needed to strengthen the program in a variety of ways.

We urge the Committee to maintain regular contact with DHS to ensure that the short-term and long-term benefits of the NFIP are realized in the coming years. To that end, we urge that you monitor FEMA's budget to ensure that adequate funds are requested to accomplish the goals set forth in authorizing legislation.

5. The Importance of Continued Federal-State Partnerships

During deliberations surrounding creation of the Department of Homeland Security, the Administration singled out FEMA's ability to develop state partnerships. The Association has long worked productively with FEMA to accomplish the goals of the NFIP and the development and implementation of mitigation initiatives. Our state members must continue to be recognized as equal partners.

The NFIP currently has over 19,600 participating counties, towns, parishes, cities, boroughs and villages. FEMA has insufficient staff to meet the current demand for technical assistance, training, visits and monitoring of these thousands of communities, much less a new initiative. Not only do states work to provided assistance in these activities, in many ways they are much better equipped to help communities integrate the NFIP and mitigation into many other local programs with related goals. Early in the program, federal funding was provided for states to building state capacity. About 15 years ago, the focus of funding provided to states was appropriately shifted to serving community needs. That program, called the Community Assistance Program, currently funds at least part of one position in each state, referred to as the NFIP State Coordinator. Despite the benefits of this program – and there are many – it has not kept pace with the demands. The demands come from FEMA and communities and citizens. FEMA wants the NFIP State Coordinator to do more and more (see map modernization initiative, below). Communities, under growing development pressure and an increasing number of damaging floods, often are unable to obtain critical technical assistance due to insufficient state staffing associated with the NFIP.

We urge the Committee to examine the long-term merits of building on this particular federal-state

partnership. The Community Assistance Program is funded by NFIP policyholder income, and has been level funded for over a decade despite increases in the number of policies. The Association appreciates FEMA's recent request for additional funds. Our state members cannot meet the demands of the NFIP and the needs of nearly 20,000 communities without the increase.

6. THE ROLE OF THE STATES IN FEMA'S MAP MODERNIZATION INITIATIVE

The importance of modernizing and updating flood hazard maps is now widely understood and, based on the FY03 budget and the Administration's proposed FY04 budget, funding is being provided. The initiative will span 8 to 9 years, but the end products will be converted to modern technology that will facilitate administering programs to reduce flood losses in nearly 20,000 communities and lower long-term costs to maintain the maps.

Each State's NFIP State Coordinating Office will experience a significant increase in workload associated with the map modernization initiative. Besides working with them to get accurate updated maps, many communities will need technical assistance in order to appropriately revise their floodplain management ordinances once the map is completed. There will be a continuing need to monitor priorities. Importantly, as FEMA is directed to encourage partnerships in the allocation of map funds, the NFIP State Coordinator will play an expanded role in coordinating with other state agencies that may have resources to contribute and leverage federal dollars.

7. THE EFFECTIVENESS AND VALUE OF THE NATIONAL FLOOD INSURANCE PROGRAM AND FEMA'S FLOOD MITIGATION PROGRAMS

The National Flood Insurance Program is the nation's oldest flood mitigation program. Its unique arrangement: the federal government establishes regulatory standards, issues Flood Insurance Rate Maps, and provides the insurance; the private insurance sector sells insurance and the engineering community performs engineering and planning studies; the states coordinate the program and provide technical assistance to communities; and local jurisdictions that must adopt, administer, and enforce floodplain regulations. This arrangement contributes to the program's effectiveness. FEMA has estimated that over $1 billion in damages are avoided each year due to the presence of state and local regulatory requirements. These savings accrue in part to the U.S. taxpayer because compliant construction is much less likely to sustain damage and because insured property owners are unlikely to qualify for disaster assistance.

FEMA's other flood mitigation programs require communities to plan in a systematic way to reduce flood risk, increasing overall disaster resistance and sustainability. In addition to the obvious benefits to owners of structures that are mitigated, there are multiple benefits to the community. Although often more difficult to quantify in strict benefit:cost models, these multiple benefits are critical to individual quality of life and a community's economic vitality.

7. EXISTING MITIGATION PROGRAMS ARE BEING JEOPARDIZED

Flood Mitigation Assistance Program: This program was authorized in 1994 by this Committee specifically to focus on repetitive losses and substantially damaged property, including property threatened by imminent collapse due to erosion. It is funded entirely by the flood insurance policyholders. The Association is gravely concerned because the FY2004 budget proposes combining these funds with those appropriated for the new Nationwide Pre-Disaster Competitive Mitigation Program (see below). While some accounting efficiencies may result, it creates the potential for significant administrative complications. Importantly, because the FMA funds derive from policyholders they must be used solely for the purposes authorized, and, we submit, they

should continue to be administered under current procedures. We urge the Committee to express its intent that FMA not be combined with the proposed new program.

Nationwide Pre-Disaster Competitive Mitigation Program: Association has prepared extensive comments regarding administrative complications and other problems with this new competitive program, funded by the FY2003 budget. The ASFPM has long supported mitigation, both in pre- and post-disaster settings; however, we feel there are problems with the approach approved in 2003, in part because it is at the expense of the existing post-disaster Hazard Mitigation Grant Program (see below) which has been cut in half. With regard to the competitive program, we are concerned that it will be driven solely by numbers and that small communities will be at an unfair advantage. We also believe that non-structural flood mitigation projects (acquisition, elevation, floodproofing) will not fare well against projects that deal with other hazards, such as seismic retrofitting.

Hazard Mitigation Grant Program: It is notable that through the FY2003 budget process, the amount of mitigation funding made available in the post-disaster period was halved, and is proposed for termination in FY2004. This program is formula-based, resulting in funds for mitigation as a function of the total federal cost of disaster assistance. It provides funding at the most opportune time, after a federally declared disaster. While we endorse pre-disaster efforts, we believe this limitation will severely hamper mitigation when people are most aware of the benefits and when they are most aware of their risk and are willing to participate and leverage other funds.

CONCLUSION

We appreciate that Congress has provided an array of flood mitigation tools which, when appropriately used, will greatly increase the prospects that communities, states, and businesses and families can be truly resistant to future flood disasters. Refocusing the Repetitive Loss Initiative and amending the Increased Cost of Compliance provision are important next steps.

Thank you for the opportunity to provide our thoughts on these important issues. The ASFPM and its members look forward to working with you as we move towards a common goal of improving state and local capabilities to reduce flood losses.

For more information, contact Larry Larson, Executive Director, (608) 274-0123, (larry@floods.org) or Rebecca Quinn, Legislative Officer (410) 267-6968 (rcquinn@earthlink.net).

Testimony of
Anthony S. Lowe
Federal Insurance Administrator
Director, Mitigation Division
Emergency Preparedness and Response Directorate
Department of Homeland Security
before
The U.S. House of Representatives
Committee on Financial Services
Subcommittee on Housing and Community Opportunity
April 1, 2003

Chairman Ney, Ranking Member Waters, and Members of the Subcommittee, I am Anthony S. Lowe, Federal Insurance Administrator, and Director of the Mitigation Division of the Emergency Preparedness and Response Directorate of the Department of Homeland Security. On behalf of the National Flood Insurance Program, we welcome and appreciate the invitation to appear today before the Subcommittee on Housing and Community Opportunity.

I would like to address the issue of repetitive flood loss properties within the entire context of the National Flood Insurance Program (NFIP) and its history.

We are pleased to report to the Subcommittee that the state of the NFIP is sound, and we are implementing a number of management initiatives to build upon the program's past successes and current strengths while making the necessary adjustments for the future.

To measure how far the program has come, it is helpful to revisit its origins.

This summer marks 35 years since Congress first authorized the NFIP.

The NFIP was one of three property insurance programs Congress authorized in the late 1960's to fill serious gaps in the private insurance market.

In 1968, the Riot Reinsurance Program and the Federal Crime Insurance Program commanded immediate national attention because of their topical interest and their mission to serve disenfranchised property owners in the Nation's cities. Many urban property owners had been denied or were in danger of losing the most basic forms of property insurance protection simply because of where they lived or conducted business. Since insurance is the cornerstone of credit, these programs became an urgent stopgap to provide property insurance coverage essential for the survival of America's cities.

The NFIP met a different property insurance need: to offer flood insurance, virtually unavailable in the private market, to those exposed to flood hazards across the country. The series of devastating hurricanes and storms in the early to mid-60's underscored the need for this coverage. The program at the outset, however, was

voluntary. Flood-prone communities faced no economic consequences for not joining the program. Property owners at risk from flooding were not required to buy flood insurance as a condition for direct Federal financial assistance or for a federally-related mortgage. The program started with a handful of policies and grew to only about 272,500 policies by the end of fiscal year 1973 under the voluntary program. But two pieces of legislation changed the program's levels of participation.

As a result of devastating floods in the early 1970's, when relatively few flood-prone communities and property owners took advantage of the flood insurance program, Congress enacted the Flood Disaster Protection Act of 1973. The 1973 Act mandated the purchase of flood insurance as a condition for federally-related mortgages and for direct Federal financial assistance, such as Federal disaster assistance or FHA or VA loans, if the property was in a special flood hazard area. The 1973 Act also required the identification of the nation's special flood hazard areas and offered identified flood-prone communities the choice of either joining the NFIP or facing the loss of Federal financial assistance in their high-risk flood areas. As a result of these provisions, the number of communities in the NFIP grew from roughly 5,520 to more than 18,600 during the next 20 years. Also, by the end of fiscal year 1994, the number of flood insurance policies in force had grown tenfold, as a result of the mandatory provisions, to 2.8 million policies.

Over time, it was clear that the program needed reforms to ensure compliance by lenders with the flood insurance purchase and retention requirements of the 1973 Act. The National Flood Insurance Reform Act of 1994 mandated reforms and gave lenders compliance tools to ensure that all appropriate borrowers bought and maintained flood insurance protection, as required by the 1973 Act. The reforms of that legislation increased the number of participating communities from about 18,600 to roughly 20,000 today. The reform legislation also resulted in another surge of policies in force from 2.8 million policies to more than 4.4 million policies today totaling $637 billion in coverage.

The NFIP now stands as the largest, single-line property insurance writer in the United States.

Today, the nearly 20,000 participating communities across America have adopted and are enforcing the program's mitigation standards to protect new buildings from flood hazards. The floodplain management standards that these participating communities are implementing form part of an overall strategy that benefits the entire floodplain, and, in a number of cases, hold the line altogether on new construction in the flood hazard areas. As a result, every property owner in those participating communities can buy flood insurance protection.

Claim payments for flood damage under the NFIP reduce the burden on the taxpayers for Federal disaster relief. The mitigation standards of the program to elevate or flood-proof new construction in flood-prone areas are reducing America's flood damages by an estimated $1 billion each year.

Mr. Chairman, besides the obvious successes the program is enjoying, I am also happy to report that the NFIP is once again debt-free.

As you know, the program does not receive appropriations to pay for its operations. It is self-supporting through the premium income from our policyholders. When flood losses exceed our reserves, we have authority to borrow funds from the U.S. Treasury to pay for those losses. But whenever we do have to borrow from the Treasury to pay for historically high losses, we must repay with interest what we borrowed. We have done this twice in our history.

In June of 2001, for example, Tropical Storm Allison battered the Gulf Coast and East Coast States. After the final losses were tallied, Allison became, sadly, the program's first billion-dollar storm, and we had to borrow $660 million from the Treasury to pay for losses that exceeded our reserves. We repaid that debt, with interest, as of October 2002, as we did once before after heavy losses in the late 1990's.

On the human scale, however, 30,000 of Allison's victims received claim payments from the NFIP rather than relying on Federal disaster relief. The benefit of flood insurance is farther-reaching than just that number since many of those policyholders had families and businesses that benefited directly and indirectly from the program, proving again the value of the flood insurance program, which helps America recover from the devastating effects of flood.

So once again the NFIP is operating debt-free, and the program continues to stand on solid financial ground.

I am also pleased to report that we are making the most of the program's insurance mechanism to achieve mitigation. We have increased the benefits of Coverage D of the Standard Flood Insurance Policy (Coverage D is the benefit under our flood insurance policy to help pay for the increased costs of complying with State and local laws or ordinances that require elevation or flood-proofing or other mitigation measures after substantial or repetitive flood losses.). The increase in benefits from $20,000 to $30,000, to become effective May 1, 2003, is an important mitigation tool and enables more of our policyholders, through their flood insurance policies, to comply with State or local laws to elevate, flood-proof, or otherwise mitigate their building after a substantial flood loss. (The benefit is also available to mitigate repetitive flood losses in those communities that have voluntarily adopted and are enforcing repetitive flood loss ordinances.)

This benefit, which supports any number of mitigation techniques—elevation, demolition, flood-proofing, or relocating the structure so that it prevents flood damage—helps break the devastating cycle of flood damage and repair and further damage.

Many of our partners at the State and local levels of government have been eager to see the increase in this benefit. This is one more example where flood insurance provides the bridge to mitigation to prevent future losses. It is another example where

the program is reducing costs to the taxpayers, and I am pleased to report that a new actuarial analysis permits us to offer this increase in benefits to our policyholders at no increase in premium.

But the NFIP is not without challenges or issues of concern.

During the floor debate on January 8, 2003, Members of the House Financial Services Committee discussed the reauthorization of the NFIP within the context of reforms, and particularly the problem of repetitive flood loss properties.

I would like to preface any discussion of possible reforms for the NFIP, and especially the problem of repetitive flood loss properties, with a description of the management initiatives we have undertaken that will improve the overall operation of the NFIP. Systemic changes must be in place in order to make the most effective use of the program.

To increase efficiencies in our flood insurance operations, the NFIP is in the process of modernizing its existing systems used to process flood insurance. We are moving to an E-commerce model, which will make flood insurance more "user-friendly" and position the program to increase the number of policies-in-force, while minimizing the total cost to the program along the entire value chain.

Additional reforms that we have inaugurated for the NFIP include:

- "managing for results" with a clear emphasis on outcomes and results rather than process or activity;
- leveraging resources from the State, local, regional levels of government as well as the private sector to make the most of our funding in map modernization and mitigation;
- taking advantage of economies of scale in our hazards studies so that we focus on basin-wide studies, wherever possible, rather than a community-by-community approach;
- building capability among those with the greatest stake in our programs, namely the State and local governments, the first-line of defense for flood hazard mitigation; and
- applying a "metrics-approach" to our resources so that we account for every dollar, every contract component, and every staff hour and apply them solely to outputs that serve the basic mission of the program, namely, to reduce the losses of life and property from floods.

These management reforms apply not only to our Flood Map Modernization Program but also to the mitigation funding opportunities that will address, among other concerns, repetitive flood loss properties.

Mitigating the highest risks, which include repetitive flood loss properties, also requires accurate risk assessment. That is why our Flood Map Modernization initiative is critical to our efforts to reduce the exposure of people and property to flood hazards. Modernizing our flood maps, however, requires time and money.

Congress appropriated $150 million in fiscal year 2003 for flood map modernization. This will be added to the approximately $50 million in funding from NFIP fees that contribute annually to the mapping program. This combination of funds enables us to embark on a multi-year effort that will cost approximately $1 billion.

We approach this multi-year effort with the certainty that to be successful we must leverage all of our partnerships—State, local, and regional entities as well as other Federal agencies and the private sector.

As I mentioned, we are implementing a results-based management system to accomplish this for fiscal year 2003 on time and within budget. There is a good reason for this: results-based projects encourage stakeholders to be innovative and find cost-effective ways of delivering services. By shifting the focus from process to results, we will achieve better outcomes.

This retooling will require resources as we develop the required systems and we improve our own capabilities to manage for results. The transition to a performance-based approach also requires that we further modernize some of our existing systems (e.g., data archiving and distribution) to take advantage of new technologies. We will help our State, regional, and local partners in this transition to develop management plans and identify the reporting tools that enable us to document program results.

We are also aware that many States, communities, and other government entities, such as flood control districts and regional planning commissions, are capable of producing high-quality, cost-effective flood hazard data. This number continues to grow and many States and communities realize the value of investing in programs that save lives and reduce property losses from flooding.

Our Cooperating Technical Partners (CTP) program has leveraged contributions from these capable entities to produce flood hazard data, increasing the value of the dollars we have spent in these jurisdictions by 220 percent nationwide. We plan to build further capability and increase the number of partnerships.

Where there is such knowledge and capability, we intend to develop cost-effective partnerships that promote community "ownership" of flood data as they are revised—ownership that will reduce the need for the Federal Government to undertake large-scale flood map updating in the future.

Local governments already implement the floodplain management standards of the NFIP. So, where the interest and capability exist, hazard identification activities should also be accomplished locally. We will continue to expand flood hazard identification training and technical assistance. This will increase the capability of our partners to produce and maintain flood hazard data. We will also continue to engage the private sector, and, where appropriate, utilize the private sector in support of our mission. The end result will be a decentralized system where those most affected by the flood hazard produce the data.

We plan to implement a two-pronged approach for updating the nation's flood hazard data inventory. First, with buy-in by our State and local partners, we are developing an approach that focuses on high-risk areas. Specifically, we will target areas with high growth, high population, and a history of significant flood losses. This will best serve our mission to reduce losses of life and property. To take advantage of economies of scale in these areas, we are investigating the feasibility of basin-wide studies. The second prong of our approach involves capitalizing on areas that have existing data that can be quickly and efficiently converted to flood hazard data that supports the NFIP. This approach provides a framework for prioritizing projects and is scalable to accommodate available funding. Ultimately, all outdated flood hazard data will be updated.

A key component of the Flood Map Modernization initiative is improving E-Government processes for flood hazard data creation and distribution. Through the Multi-Hazard Flood Map Modernization Program, we will enable easy access and exchange of flood hazard data through the Internet. This system will also provide tools that enable clients to more effectively use flood risk information. The geospatial nature of the data and the Internet delivery system will help facilitate not only the use of flood hazard data but also the sharing of its components for the management of all hazards.

The net result of these improvements will be higher satisfaction of the NFIP's stakeholders and customers who rely on flood hazard data to make crucial decisions that reduce their vulnerability to flood risks.

With the resources we have for this fiscal year, for both flood map modernization efforts and mitigation projects, we can focus on our highest priorities.

The strategic thinking and planning we have undertaken for our fiscal year 2003 funds is setting the stage for future economies, bigger payoffs, and even greater accomplishments with the funding levels proposed in the President's 2004 budget.

Our efforts this fiscal year will reduce the number of people, property, and infrastructure exposed to flood hazards and other natural perils.

What we are doing this fiscal year to manage our flood map modernization and natural hazard mitigation efforts will also help build a platform for the Department of

Homeland Security to secure the nation from the full range of hazards, natural and man-made, including repetitive flood loss properties.

But the problem of repetitive flood loss properties is complex.

We see repetitive flood losses as a national problem. From a national perspective, paying claims for the same properties time and again is just not good public policy, and it is not sound business practice or prudent stewardship. We are spending far too much in claims dollars on just a handful of properties, a costly drain on our program.

To a degree, the problem of repetitive flood loss properties is also a vestige of the past.

Congress structured the NFIP as an agreement between the Federal Government and local communities.

The terms of the agreement call for communities to adopt and enforce mitigation standards for new construction in their high-risk flood areas. In return, flood insurance is made available to all properties built before the availability of detailed flood risk information at premium rates that do not fully reflect the true risk. Congress intended discounted premium rates for such existing properties in order not to penalize those who bought or built in the floodplain without full knowledge of the flood hazard. These property owners were permitted to pay less than full-risk premiums for flood coverage, which private insurance companies would not even offer.

We call these properties "pre-Flood Insurance Rate Map" or "pre-FIRM" properties. Repetitive flood loss properties are for the most part a sub-set of these pre-FIRM structures.

There have been good public policy reasons for providing insurance to these older properties at less than full-risk premiums, but properties that flood over and over again lock their owners into a dismal cycle of damage and repair—with diminishing property values and often no way out. We must find more efficient ways to address the highest risk properties.

Two Bills have been introduced in the 108th Congress to address the problem of repetitive flood loss properties.

I commend the sponsors for their leadership in focusing attention on this national problem and proposing remedies for people caught in the devastating cycle of damage-repair-damage.

I would like to preface any discussion of the tools needed to resolve this problem with an outline of some of the obstacles we have faced in trying to move the owners of repetitive flood loss properties out of harm's way.

All of our mitigation programs are voluntary, so we have not always had the needed leverage for repetitive flood loss property owners to accept grant offers intended to reduce or eliminate the flood risk.

More importantly, there are financial constraints that sometimes prevent owners of repetitive flood loss properties from accepting offers for buyouts. Our mitigation programs, by law, require a 25 percent non-Federal cost-share. In a number of cases the responsibility for the match has devolved from the State and local government to the property owner. When buyouts are the most cost-effective option and the cost-share falls to the property owner, it is financially impossible for many of the property owners to assume that cost—25 percent of the fair market value of the property.

When there *is* a cost share available from the State or local government, the repetitive flood loss property owner often faces other problems that argue against accepting a mitigation grant offer. In some cases, the geography of the floodplain offers few, if any, flood-free, alternate living sites in the vicinity where the affected property owners work or their children go to school. If there *is* alternate housing in the vicinity, it may not always be affordable, which again makes it impossible for property owners to accept the offer and make the move. Communities implementing the program must also consider the mitigation remedy in the total context of a community's comprehensive floodplain management program, since repetitive flood loss properties are parts of neighborhoods and subdivisions and have a relationship to entire communities.

Those are realities and the realistic constraints of any mitigation grant program for the owners of repetitive flood loss properties. And with those constraints in mind, these are the tools necessary to address the repetitive loss problem:

Resources are clearly necessary. The more resources that are available to address repetitive loss properties, the quicker significant progress can be made.

Flexibility is key in determining the composition of repetitive loss projects and in defining our highest priority properties.

The involvement of State and local governments in the disposition of properties is important in keeping control at the local level and not having the Federal government become an owner of these properties.

And finally, there should be some consequence for a property owner that refuses a mitigation offer, without justifiable reason.

Mitigation projects are usually the most successful with State and local governments involved in their development and execution. Certainly where there is a non-Federal cost share requirement, these entities have a stake in the process and outcome. There will be instances, however, where in the interest of savings for the National Flood Insurance Program, we will need to address individual properties that are not part of any larger mitigation effort. And, we must also be mindful that there may be

individual circumstances where, with legitimate reason, property owners cannot avail themselves of mitigation assistance.

A broad effort that has the flexibility to recognize individual circumstance when necessary will give us the means to address the repetitive loss problem in ways that can be refined based on what we learn, on the ground, about these properties. We can achieve results that are good for the community, the individual property owner, and the National Flood Insurance Program.

Currently, we have targeted 10,000 repetitive flood loss properties as the highest priority for mitigation in our repetitive loss strategy. These 10,000 high priority properties, which are currently insured under the NFIP, have had *four* or more flood losses, or two or three losses that cumulatively exceed the value of the building. These 10,000 are the "extreme cases," ones that we have paid out close to one billion dollars in flood insurance claims over the last 21 years. We want to target these properties for mitigation that will remove them altogether from the floodplains, elevate them above the reach of floodwaters, or apply other measures to reduce significantly their exposure to flood risk.

The measures I have described would give us a complete set of tools to remove the costliest risks from the NFIP.

In the meantime, this is what we are doing to address the problem of repetitive loss properties: we have set up a special direct facility for selling and servicing flood insurance on these properties to better coordinate claims handling for them. We are making more flood loss data available to State and local governments for mitigation projects. We are also offering incentives under our Community Rating System, or CRS program, to communities to address this issue locally. Under the CRS, we have expanded the premium discounts available for local mitigation actions.

How we fully address the problem still needs to be resolved, but we are all in agreement: we need to address the problem, which affects not only individual property owners but also entire communities since properties that flood time and again can diminish not only neighborhoods but entire communities as well.

In closing, I appreciate the opportunity to represent the Department of Homeland Security before the Subcommittee on Housing and Community Opportunity of the Committee on Financial Services. I am pleased to answer any questions you may have.

TESTIMONY OF GERALD J. NIELSEN BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY CONCERNING THE NATIONAL FLOOD INSURANCE PROGRAM

Thank you for the opportunity to present information to the Committee concerning the opinions held by the undersigned as to how the National Flood Insurance Act could be improved, made less costly, and made even more of a success than it already is at present.

EXECUTIVE SUMMARY

The undersigned will address each of the four bullet points referenced in Congressman Bob Ney's letter extending the invitation to testify dated March 25, 2003. These four points are as follows:

- The effectiveness and value of the National Flood Insurance Program and FEMA's flood mitigation programs;
- The need to reauthorize the NFIP before the end of the year and what changes, if any, should be made to the program before it is reauthorized;
- The effect on your insurance industry clients as well as on flood insurance policyholders and the real estate market when there is a lapse in reauthorization of the NFIP;
- Your proposals for saving the National Flood Insurance Program money by decreasing its litigation costs.

As to the first point, the undersigned will offer his view of what are the two most important benefits of the NFIP, and also note what a few courts have said as to their understanding of what the Program is designed to achieve.

As to the second point, it is submitted that any reauthorization should include a second revision of the Program jurisdictional statute. This point is the primary focus of the undersigned's testimony. Just as occurred in 1983, several court cases have sparked an expensive and unintended

battle over whether the states have jurisdiction and regulatory control over the procedures and rules for how the United States Treasury is placed at risk by insurance agents and insurance companies involved in the issuance of NFIP policies. We currently have the states holding that the federal courts have sole jurisdiction over how the policies are sold, and federal courts holding that state courts have sole jurisdiction over this issue.

Third, the Program would most certainly operate more smoothly if it could be reauthorized for terms exceeding two years. The uncertainty of not knowing if the Program will actually be reauthorized, and whether the complicated systems that are needed to keep it operating must be turned off on short notice, is a problem that most likely could be avoided. The latest lapse, for instance, was a logistical and legal nightmare for the companies. The processing systems that handle policy administration simply could not be stopped in the timeframe allotted by the first notice that reauthorization was a problem.

The principal cost savings that Congress can provide in terms of Program litigation, is the revision of the jurisdictional statute. The benefits of that revision will be explained within this written testimony. Other significant savings could be achieved from the resolution of two other matters involving dealings between the carriers and FEMA. These other matters actually need to be dealt with within FEMA in the first instance, but also must be noted herein to at least alert the Congress to these issues. They are extremely serious from the perspective of the carriers, and are the cause of certain carriers considering leaving the NFIP.

BACKGROUND OF THE WITNESS

The undersigned has been practicing in the field of flood insurance litigation since 1988. Currently, virtually every major participant "Write-Your-Own Program" ("WYO")[1] insurance company in the NFIP utilizes Nielsen Law Firm, L.L.C. to handle its NFIP-related litigation on a national basis. If one were to run a Westlaw search of the undersigned's name and the word "flood," one would find that the majority of all Program caselaw being announced in the country over the last few years lists the undersigned as the attorney of record for the WYO carrier. Just recently, the undersigned won his *tenth* appellate decision in a row for the Program. In addition, the undersigned teaches the workings of the NFIP to adjusters, insurance agents, and insurance company personnel. He has also given seminars to the general adjusters of the NFIP Bureau and Statistical Agent, and taught the NFIP to newly hired agents of FEMA's Office of Inspector General.

Also, the undersigned is not exactly an "insurance defense" counsel. It is not that there is anything wrong with that designation; it is just that it does not fit. Essentially 100% of Nielsen Law Firm's workload has always involved governmental interest litigation. The firm's practice focuses upon the representation of municipal, state, and federal governmental systems and officials. The undersigned is General Counsel to the Louisiana Association of Chiefs of Police, and also practices extensively in the fields of civil rights and constitutional tort litigation. The firm's efforts to work with the WYO Program insurance carriers to build an effective body of caselaw to govern the operations of the NFIP on a nationwide basis is seen as a complementary adjunct to the firm's representation of various governmental interests of the State of Louisiana and its numerous municipalities and municipal officials.

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[1] 44 C.F.R. Pt. 62.23, *et seq.*

1. EFFECTIVENESS AND VALUE OF THE NFIP

The NFIP is believed by the undersigned to be one of the finest examples of a public-private partnership ever devised in this country. It functions exceptionally well. Its effectiveness and value are in two primary areas:

First, the premiums received through the Program allow the Government to defray a large portion of all costs attendant to flood disaster relief. It also allows the Government a mechanism through which it can change behaviors, specifically in the areas of construction and zoning, so as to mitigate future loss of life and property. By utilizing an insurance model to collect revenues specific to these issues, the particular citizens who are most likely to have need of flood disaster assistance, are the exact people who will purchase flood insurance so as to help build a pool of funds to help defer the costs of natural disasters.

Also, the Program's use of insurance companies and insurance agents in this regard results in significantly higher premium revenues to the Program. Prior to the decision made in 1983 to enlist the aid of the insurance companies in the Write-Your-Own Program, the policy count stood at less than 2 million policies. Currently, the policy count is in the neighborhood of 5 million policies. That is two and one-half times the premium revenue as a result of utilizing this country's insurance companies and insurance agents to make the Program a success.

The second critical benefit received by the Federal Government from the operation of the NFIP is this: After a flood disaster, the economy of a community devastated by a flood has literally been turned off. Every large business, as well as every "mom and pop" shop, ceases operation. The economic impact of the flood upon that community depends in large part on how quickly those businesses restart their operations. In other words, if it takes six months to infuse federal benefits

back into a community that has been affected by a flood, many small and large businesses will no longer be there, thus exacerbating the economic impact of the disaster.

The current operating system of the NFIP, which utilizes the expertise of insurance companies and various adjusting organizations, handles claims very rapidly. Huge amounts of federal dollars are infused into communities affected by flood disasters in a matter of 30 to 60 days, rather than a matter of 120 days or more as might occur in a normal grant process. Also, the money flows accurately and to the specific individuals who have been affected by the flooding.

A great example of the success of the Program is what happened in Houston after Tropical Storm Allison. Literally thousands of homes and businesses flooded in that storm. The event could have been an economic disaster for the City of Houston. However, given the rapidity within which the claims handling processes of the NFIP's insurance carriers responded, Allison is now but a blip on the economic radar of Houston's history. *But for* those quick and accurate claims handling systems of the NFIP's insurance carriers, the overall costs of revitalizing Houston after Tropical Storm Allison would no doubt have been far higher. It follows then that the overall costs to the Federal Government would have been far higher.

The NFIP has now been in existence for over 30 years. In that time, several judicial opinions have commented upon *why* the Congress implemented the Program, and *why* the Federal Government utilizes the services of private insurance companies to make it a success. As to the purpose of the Program, one court noted this:

> The principal purpose in enacting the Program was to reduce, by implementation of adequate land use controls and flood insurance, the massive burden on the federal fisc of the ever-increasing federal flood disaster assistance. *Till v. Unifirst Federal Savings & Loan Assoc.*, 653 F.2d 152, 159 (5th Cir. 1981)

As to why FEMA utilizes private insurance companies, the U.S. Seventh Circuit Court of Appeals recently made this observation:

> [A]lthough private insurers issue the policies, FEMA underwrites the risk. The insurance companies handle administrative business for FEMA by selling policies and processing claims but do little else (unlike the Industry Program, where the private companies underwrite the risk). Arrangements like this make sense. FEMA likely is unsuited to tasks such as selling insurance and collecting fees, and even less adept at processing individual claims for flood damage. By purchasing the services of a more efficient claims processor, FEMA saves money. *Downey v. State Farm*, 266 F.3d 675, 679-80 (7th Cir. 2001)

2. THE NEED TO REAUTHORIZE THE NFIP, AND WHAT CHANGES SHOULD BE MADE

The justification for a reauthorization of the NFIP is best demonstrated by comparing the recovery of communities affected by flood disasters before the NFIP, to those that have suffered flood disasters after its adoption by the Congress. Communities for whom the NFIP was not there to jumpstart a recovery, took far longer to recover after a flood disaster. In addition, one may see the practical changes caused by the NFIP by visiting countless coastal communities to see how building practices have changed all along our country's seaboard. As a direct result of the NFIP, building practices have been altered so as to lessen the loss of both property and life due to flood disasters.

Before considering the proposed change to the Act to be submitted below, the Committee is asked to ponder that the current operating system of the NFIP is the Federal Government's third attempt to operate the Program. The first two efforts failed. From 1968 until 1978, the Program was operated by a pool of insurers. This first system failed, largely due to a lack of leadership. In 1978, the Government ended the insurers' involvement, and sought to operate the Program without industry assistance from 1978 until 1983. This second effort likewise failed, largely due to the fact

that the Government lacked the expertise possessed by the insurance industry.

In 1983, someone devised a simple yet brilliant plan - - marry the expertise of the insurance industry to the leadership that only meaningful Government control could provide. In other words, and using the best parts of the two prior systems, it was decided that the Government would act as the general, and the carriers would act as the army. For 20 years, that which FEMA implemented under the title "Write-Your-Own" Program,[2] and which FEMA has always called a "partnership," has succeeded beyond all expectations.

Over 93% of all policies are now written through the private insurers who have chosen to partner with FEMA to make the NFIP actually operate successfully. Note, that while there are far more than 100 property insurers in this country, and while approximately 100 of these have actually signed on to participate in the Program, the number of carriers that actually and meaningfully participate with large numbers of policies in force is down to about 15. Just 15 private companies shoulder almost all of the burden of actually making the Program work. Their expertise is of immense value to the Program.

A. The Problem

Currently, the carriers are becoming increasingly nervous over where the Program is heading. One of the main reasons for this is that the federal courts are having a very difficult time with NFIP jurisdictional issues. This confusion, which the Congress was able to ameliorate once before, is costing the Program a small fortune in terms of litigation bills, and in unnecessary settlements. The problem is growing, for now it is published fact, as a result of recent judicial decisions. The problem is this:

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[2] 44 C.F.R. Pt. 62.23, *et seq.*

Everyone seems to still agree that jurisdiction over claims for benefits upon a flood insurance policy must be filed in the federal courts. (There is very little agreement as to why this is true, just that it is.) However, if a plaintiff's counsel chooses to try to evade the Congress's command of "exclusive" federal court jurisdiction found at 42 U.S.C. §4072, by making claims that the reason the claim was not paid relates to how the policy was originally sold or issued, (a.k.a. through "artful pleadings") the courts are unsure of who has jurisdiction. Plainly, when the issue of jurisdiction is unclear, no one has any idea what rules and standards of care are applicable. Do FEMA's rules govern, or do the different rules of 50 different states govern? This leads to very expensive legal battles, and unnecessary settlements, all at Program expense.[3]

The courts of the states of California and Florida have both squarely held that regardless of what type of claim is made, that jurisdiction is restricted to the federal courts. *McCormick v. Travelers Ins. Co.,* 103 Cal. Rptr.2d 258 (Cal. App. 4th Cir. 2001); *Seibels Bruce Ins. Co. v. Deville Condominium Assoc.* 786 So.2d 616 (Fla. Dist. App. 1st Cir. 2001). Reaching exactly the opposite conclusion, are U.S. district court judges in Louisiana and in Pennsylvania. See *Powers v. Autin-Gettys-Cohen Ins. Agency, Inc.,* 2000 WL 1593401 (E.D. La. Oct. 24, 2000); and *Roxbury Condominium Assoc., Inc., v. Cupo* , 01-2294 DMC (D.N.J. 9/21/01). One federal judge sitting in South Carolina ruled one way upon this question in *Houck v. State Farm,* 194 F.Supp.2d 452 (D.S.C. 2002), and then the opposite way just 30 days later in *Southpointe Villas Homeowners Association v. Scottish Insurance Agency Inc.*, 213 F.Supp.2d 586 (D.S.C. 2002).

The NFIP, like all insurance operations, has two sides. One side concerns all rules and procedures for how the risk is accepted and what policies are issued. In the context of the NFIP, this

[3] All WYO carrier defense costs are borne by the Program. *Van Holt, infra.*

regards all of the procedures pursuant to which the insurance agents and insurance companies place the U.S. Treasury at risk upon flood insurance policies. The other side concerns the claims after a flood. The procedures and rules here concern how the companies pay out money from the U.S. Treasury upon the risks previously accepted.

No one would argue that the Congress ever intended that the 50 different sets of state courts would have exclusive jurisdiction over how the U.S. Treasury was placed at risk in NFIP operations, while the courts of the Federal Government would have "exclusive" jurisdiction only over how that risk that the U.S. Government accepted as per the rulings of the 50 different state courts, would be paid upon. However, that is precisely where the Program is heading. In Louisiana and in Pennsylvania, the Program is there right now. See *Moore v. USAA*, ___ F.Supp.2d ___ (E.D. La. 2002) (2002 WL 31886719); and *Roxbury, supra*.

Only Congress can solve this problem. The Constitution provides that Congress sets the jurisdiction of the federal courts. As such, neither FEMA nor the carriers have any ability to solve this issue. Accordingly, and just as the Congress fixed an almost identical problem for the Program in 1983, it is asked to do so again now.

The current text of 42 U.S.C. §4072 is as follows:

> In the event the program is carried out as provided in section 4071 of this title, the Director shall be authorized to adjust and make payment of any claims for proved and approved losses covered by flood insurance, and upon the disallowance by the Director of any such claim, or upon the refusal of the claimant to accept the amount allowed upon any such claim, the claimant, within one year after the date of mailing of notice of disallowance or partial disallowance by the Director, may institute an action against the Director on such claim in the United States district court for the district in which the insured property or the major part thereof shall have been situated, and original exclusive jurisdiction is hereby conferred upon such court to hear and determine such action without regard to the amount in controversy.

Congress could close all avenues of attempting to evade its command that NFIP disputes be filed in the federal courts by revising the statute to read as follows:

42 U.S.C. §4072 (as proposed)

> Jurisdiction over any dispute arising out of participation, or attempted participation, in the National Flood Insurance Program shall be within the original exclusive jurisdiction of the United States district courts. Venue on all such actions shall be in the United States district court for the district in which the insured property or major part thereof shall have been situated. Any such action shall be filed within one year of the date of mailing of notice of disallowance or partial disallowance of a claim under a Standard Flood Insurance Policy, or if the dispute does not arise from a specific claim denial, one year from the date on which sufficient facts are known about the alleged harm such that reasonable inquiry would reveal the cause of action.[4]

Significant point: Revising this statute would not alter any available remedies for participants in the NFIP. In those few areas where state law remedies are indeed available, federal judges certainly have the power to adjudicate state claims along with federal claims. 28 U.S.C. §1367. Providing for uniformity of jurisdiction for all claims across the United States, such that one court system would provide a uniform rule of decision for the entire country for all Program issues, would do nothing other than make certain that whatever remedies are available in one state, mirror the remedies available in another state. Everyone would be assured the same "deal."[5]

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[4] The current 42 U.S.C. §4072 fails to set a time limit for all types of claims that could be made. The proposed language provides a rule of one year from discovery for any claim other than a direct claim for benefits under a policy. A longer period could be added if such would be deemed appropriate. The writer's only concern is that a discernable date be established, not with what that date ought to be.

[5] Also, this would not materially impact the workload of the federal courts. Litigation involving the NFIP is a very small practice area.

B. Discussion

In 1978, the original U.S. Fifth Circuit Court of Appeals wrote the seminal NFIP decision of *West v. Harris,* 573 F.2d 873 (5th Cir.1978), *cert. denied*, 99 S.Ct. 1424 (1979). Despite its age, *West* remains the most-frequently cited judicial decision in the Program's history. In *West*, the court made two points that subsequent judges have reiterated time and time again. The first, is that the flood program is a "child of Congress." *Id.* at 881. The second, is that "uniformity of decision" all across the United States is very important if the Congress's objectives are to be achieved. *Id.* at 881. This is a point that the U.S. appellate courts continue to stress today. In *Flick v. Liberty Mut. Fire Ins. Co.,* 205 F.3d 386 (9th Cir. 2000), *cert. denied*, 121 S.Ct. 305 (2000), the court predicated its ruling upon a philosophy that, "There is a compelling interest in assuring uniformity of decision in cases involving the NFIP." *Id.* at 390.

While these points are not truly subject to debate, they are currently in need of additional consideration by both the Congress and by FIMA. It is the Congress of <u>all</u> of the states that created (and now underwrites) the Program. Under no circumstance should the citizens of one state be able to get a better "deal" under the Program, or be allowed to circumvent the National Government's rules through the laws or courts of their own state. If the laws and decisions of 50 different sets of state courts govern any aspect of Program operations, that aspect will not operate on a uniform national basis. Our ship will have a hole in it.

In 1983, at the same time the Government brought the insurance companies back into the NFIP, the Congress reexamined the Program's jurisdictional statutes, and, how the courts were

interpreting those statutes at the time.[6] The legislative history of what the Congress did as to this issue in 1983, and why, was set forth in detail as follows in *Hairston v. Travelers Cas. & Surety Co.*, 232 F.3d 1348 (11th Cir 2000). In *Hairston*, the claimant wanted his flood insurance claim to be litigated in a Georgia state court, rather than in federal court. (The carriers constantly face claimants attempting the same thing.) In reviewing the issue, the U.S. Eleventh Circuit explained the following as constituting critical evidence in its review of what the Congress had actually intended:

> 2. An Unmistakable Implication From Legislative History
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> Although we need not address the legislative history in light of the explicit statutory directive and our holding that the "exclusive" language of the statute rebuts the presumption of concurrent jurisdiction, our review of the legislative history reinforces our holding. As originally enacted, §4072 did not contain the words "original exclusive" before jurisdiction. [FN4] This language was added by Congress in 1983. See Supplemental Appropriations Act, 1984; Domestic Housing and International Recovery and Financial Stability Act, Pub.L. 98-181, §451(d)(5), 97 Stat. 1229 (1983). In the accompanying legislative history, Congress made clear that the adoption of the language was purposeful:
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> In the case where the claimant refuses to accept the amount allowed oN the claim, the claimant may institute an action on the claim **against the company or other insurer** within one year after the mailing of the notice of disallowment or partial disallowment in the U.S. district court for the district in which the insured property is situated. Jurisdiction is conferred on the U.S. district court to hear and determine the action regardless of the amount in controversy. This section is amended to specify that the U.S. district court has original exclusive jurisdiction over this action.
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> See Joint Explanatory Statement of the Committee of Conference, reprinted in 1983 U.S.S.C.A.N. 1768, 1814 (emphasis added). The inclusion of the clear language restricting jurisdiction to the district court, without any qualifying statements, demonstrates Congress's intent to restrict jurisdiction.
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> The addition of the language in 1983 is especially convincing in light of the split that had developed in the federal courts about whether jurisdiction over actions

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[6] It is unlikely that it is a mere coincidence that Congress agreed to fix the jurisdictional statute in 1983, that being the same year that the insurers agreed to return to the NFIP.

> brought pursuant to NFIP policies was confined to federal courts. Compare *Bains v. Hartford Fire Insurance Co.*, 440 F.Supp. 15 (N.D.Ga.1977) (holding that concurrent jurisdiction existed); *Burrell v. Turner Corp. of Oklahoma*, 431 F.Supp. 1018 (N.D.Okla.1977)(same) with *Schultz v. Director, Federal Emergency Management Agency,* 477 F.Supp. 118 (C.D.Ill.1979) (holding the same language in the jurisdictional statute for Part A of the NFIP restricted jurisdiction to the federal courts); *Siekmann v. Kirk Mortgage Co.*, 548 F.Supp. 50 (E.D.Pa.1982)(same). Thus it would appear that Congress was responding to the growing split and amended the statute in order to alleviate any further confusion. Because we conclude that both the language of the statute and the legislative history dictate the conclusion that the federal courts have exclusive jurisdiction, we decline to consider the third potential rebuttal factor, the compatibility of state-court jurisdiction and federal interest. (emphasis added) *Hairston,* 232 F.3d at 1351-52.

Since 1983, when the Congress last addressed this issue, two further problems have recently surfaced in the courts. These problems have developed as a result of incessant efforts by claimants to attempt to maneuver NFIP cases into the state courts. One problem is that there is no explicit reference to the insurance companies in the statute. As noted above in the *Hairston* decision, there is a reference to the companies in the legislative history. However, the reference is not actually to be found within the enacted statute. Another problem is that the word "claim" has gone unaltered within the statute since the year 1968.

In the U.S. Third, Fifth, Sixth, and Ninth Circuits Courts of Appeals, holdings exist clearly finding that 42 U.S.C. §4072 provides a rule of exclusive jurisdiction for "claims" raised against FEMA's private insurance company "Write-Your-Own Program" carriers, despite the fact that the carriers are not explicitly named within the statute. These courts essentially read 42 U.S.C. §§4071(a)(1)[7] and 4072 in *para materia*. *Van Holt v. Liberty Mutual Fire Ins. Co.,* 163 F.3d 161 (3rd Cir. 1998); *Spence v. Omaha Indemnity Ins. Co.*, 996 F.2d 793 (5th Cir. 1993); *Gibson v.*

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[7] This statute makes clear that the companies act as the "fiscal agent" of the United States. *Gowland, supra.*

American Bankers, 289 F.3d 943 (6th Cir. 2002); and *Flick, supra*.

The U.S. Seventh Circuit Court of Appeals, however, refused to hold that §4072 applies to the carriers, specifically because they are not expressly named in the statute. *Downey v. State Farm Fire & Cas. Ins. Co.,* 266 F. 3d 675, (7th Cir. 2001). In the U.S. Fourth Circuit, the situation is even less clear. In *Battle v. Seibels Bruce Insurance Company*, 288 F.3d 596 (4th Cir.2002), the U.S. Fourth Circuit looked at what had been done by the Third, Fifth, Sixth, and Ninth Circuits, and then looked at *Downey*. Finding only confusion, the U.S. Fourth Circuit decided to completely sidestep §4072, and to determine its jurisdictional foundation based upon general federal question jurisdiction. 28 U.S.C. §1331. Respectfully, when a U.S. court of appeals expressly avoids grappling with a congressionally-mandated jurisdictional statute directly on point, and specifically a statute that four other appellate courts had ruled was indeed directly on point, we have clear evidence of a problem. (The U.S. Fourth Circuit is not known for avoidance of issues involving debates over congressional intent.)

The second of the two problems that has surfaced since the 1983 congressional amendments to §4072 concerns how the courts are now interpreting the word "claim." The issue has only become important recently, because FEMA preempted all bad faith claims on the claims side of its operations approximately three years ago.[8] Currently, and specifically because plaintiffs' attorneys understand that normal bad faith claims raised in the context of NFIP claims handling issues are now barred and preempted, they are now looking for a new avenue of attack. That new avenue is to claim that the insurance agent said something untoward in the context of discussions during the sale of the policy.

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[8] For a discussion of this issue, please see *Scherz v. South Carolina Ins. Co.,* 112 F. Supp.2d 1000 (C.D.Cal. 2000); and *Neill v. State Farm Fire and Cas. Co.,* 159 F.Supp2d 770 (E.D. Pa. 2000).

The vast majority of these claims are frivolous, and nothing beyond a tactical maneuver. (Three years ago, very few such claims were being filed.) As a direct response to FEMA's decision to preempt bad faith claims, insurance agents are now seeing a dramatic increase in frivolous and unwarranted claims being raised against them.[9]

Federal courts are trying to determine whether they have jurisdiction to consider these new tactics. The problem for them comes down to this:

Does the word "claim" as found in the current §4072 apply to just the claim for coverage under the flood policy? Alternatively, does it apply to that claim and also to the claims for how the claim against the policy was handled by the insurer? (the so-called "bad faith" claims) In the further alternative, does it apply to "claims" arising out of FEMA's procedures and rules for how policies are sold and issued before a loss has occurred? As to these various possibilities, there is no way to describe the current state of the caselaw as anything other than as a mess.

The states are of a view that all three types of claims are restricted to the federal courts. The view of both Florida and California (two states with a great interest in the success of the NFIP) is that it would be absurd to hold that Congress actually intended that fully one-half of all NFIP operations would be under state court jurisdiction, while the other half would be under federal court jurisdiction. As the California appellate court explained within its *McCormick* ruling:

> We see no basis for turning the jurisdictional question on a distinction between errors allegedly committed while explaining the scope of coverage to a new policyholder and errors allegedly committed in interpreting the amount of insurance proceeds to which the policyholder is entitled following a loss. The breadth of activities WYO insurers pursue in furtherance of the NFIP encompasses procuring

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[9] Plainly, the Congress is not being asked to weigh in on the merits of this debate. All that is sought is one court system for the review of all of these debates so as to have a level playing field, and a uniform body of law whichever way the issue pans out.

policies, servicing the accounts, and processing claims. At all of these stages of the insured/insurer relationship, the workings of the NFIP are intimately involved. Moreover, treating some claims as exclusively within the jurisdiction of the federal courts and some within the concurrent subject matter jurisdiction of state courts invites the very balkanization of lawsuits FEMA forecasts with justifiable dread in its amicus brief.

Our own case illustrates the potential vice in treating misrepresentation claims jurisdictionally unique under the NFIA. In describing the interplay between the claims of misrepresentation and bad faith alleged in the first amended complaint, the McCormicks state in their opening brief: "These causes of action for misrepresentation are essentially alternative causes of action to the 'Bad Faith' cause. If coverage is ultimately held to be as interpreted by Travelers (e.g., that the Flood Policy does not cover damage from flood water *below* the standing water line inside the house), then the policy was misrepresented to the McCormicks at the time of purchase." (emphasis in original)

Therefore, were we to follow *Moore,* we would necessarily put our imprimatur on the McCormicks' strategy of allowing them to litigate in a federal forum their coverage dispute (which a state court unquestionably does not have jurisdiction to decide), while allowing their misrepresentation and related state claims to repose in state court awaiting the outcome of the federal action. Surely, this orphaning of the "child of Congress" to 50 state court jurisdictions was not the intention of Congress in establishing "a pervasive and comprehensive scheme of federal regulations setting forth the rights and responsibilities of insureds and insurers under the NFIP." (*West, supra,* 573 F.2d at p. 881; *Davis, supra,* 96 F.Supp.2d at p. 1002.)

For all of these reasons we find the decision in *Moore* unpersuasive.[10] Instead, like the federal courts, which have squarely decided the issue, we conclude that the federal courts have exclusive jurisdiction over all of the claims asserted in the McCormicks' first amended complaint. This exclusive jurisdiction encompasses all claims regardless of whether they plead contract, tort, or state statutory remedies and damages, and regardless of whether the named defendant is the FEMA or a WYO insurer. *McCormick, supra*, at 419-420.

Also, every state insurance commissioner to have examined the issue agrees with the position of California and Florida. Attached are sworn affidavits of the insurance commissioners of Texas,

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[10] Alaska, in a decision entitled *Moore v. Allstate,* 995 P.2d 231 (Alaska 2000), had disagreed. The *McCormick* decision from California explains where the earlier Alaska decision had fallen into error.

Mississippi, South Carolina, and North Carolina. (Ex. A) Each affidavit attests that the insurance commissioner of that state is of a view that his state has no jurisdiction over any NFIP operations. No commissioners are known to be in disagreement.

Federal courts, being courts of limited jurisdiction (unlike state courts), and being wary of undertaking jurisdiction where the Congress has not provided for it, have signaled a very real problem here. Unlike the state courts of California and Florida, federal courts to have examined the issue apparently believe that it would be inappropriate for them to construe the word "claim" in §4072 as encompassing claims arising out of policy procurement matters.[11] As such, they are refusing to do so. Several examples of the resulting problems are as follows:

In South Carolina, and in two cases arising out of whether higher than necessary premiums had been charged for a NFIP policy, a single federal court judge ruled in one of the cases that federal jurisdiction was absent, but then ruled just 30 days later in the second case that jurisdiction was present. *Houck, supra*, and *Southpointe, supra*, respectively.

The problem is likewise evidenced in the holdings of the U.S. Third Circuit Court of Appeals. There, it is settled law that §4072 applies to "claims" under policies, as well as to "claims" as to how the claim under the policy was handled. *Van Holt v. Liberty Mutual, supra*; and *Linder & Assoc. v. Aetna*, 166 F.3d 547, FN 3 (3rd Cir. 1999). However, to avoid these two holdings, a claimant need only avoid making these *types* of claims. This occurred in the matter now to be discussed.

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[11] Note, that the cases usually come to the federal courts pursuant to removal jurisdiction. In that setting, federal courts are all but required to construe the assertion of their jurisdiction narrowly.

In *Roxbury Condominium v. Selective,* the WYO carrier was sued upon allegations that the legal duties applicable to the sale of flood policies had been breached. While the claim was pleaded as being one of negligence under state law, it is noteworthy that all applicable duties and standards of care were those set by FIMA as a uniform rule for the whole country. Selective removed the case from state court to federal court. In response, a U.S. district court judge sitting in New Jersey remanded the case back to state court and also imposed attorneys fees upon Selective for having asserted that such a dispute could possibly come within the jurisdiction of the federal courts. In other words, FIMA's WYO carrier was sanctioned for having argued that the courts of the United States had jurisdiction over the procedures for how the United States Treasury was placed at risk in the context of the United States Congress's NFIP. This was indeed a surprising ruling. However, given that remand orders may not be appealed, Selective was limited to appealing only the award of attorneys fees. The U.S. Third Circuit reversed that award, noting upon its review of the underlying remand order that the insurer's jurisdictional argument was "colorable." *Roxbury Condo v. Selective, supra.*

Consider - - the current operating system for the NFIP has been up and running for 20 years, and it is at this juncture still only arguable that a federal judge might have jurisdiction over fully one-half of Program operations.

To be sure, FEMA has adopted a plethora of rules and procedures and guidelines on both sides of NFIP operations, that being both the sale of the policies, as well as the procedures for payment of the claims. Any rule FEMA adopts on either side of the operations must be enforced by the carriers. If 50 different sets of state courts each get to decide when they think it was reasonable for the flood carrier to have refused to do what the plaintiff's attorney claims would have been "fair,"

and instead enforced FEMA's rules, the system will not be operating for long. The few carriers that continue to work with FEMA to make the Program work will likely bolt.

In closing as to this issue, if Congress provides for exclusive jurisdiction over all NFIP operations in the federal courts of the United States, then the Congress will reap the benefit of significant cost savings. If all disputes are to be resolved on a uniform basis in one court system, and if all debates over jurisdiction are put at an end, the Congress receives a lower bill for litigation costs, and, bolsters the development of a uniform body of caselaw to govern all NFIP operations. As more issues become the subject of settled caselaw, Program costs drop even further. We achieve greater efficiency, and we achieve lower costs. Also, we achieve for all NFIP participants, a clearer understanding of everyone's rights and responsibilities.

Only the Congress can fix this problem. It did so in 1983. It is asked to do so again.

3. Effect of Lapse in Reauthorization

As the Committee is well aware, the insurance and banking industries learned with less than 60-days notice that the Program was to lapse without reauthorization effective December 31, 2002. Prior to that notice, everyone had assumed that reauthorization would occur as a matter of course. The lack of reauthorization caused a logistical and legal nightmare for the insurance and banking industries.

For the insurers, the Committee is asked to consider the enormous machinery that actually operates the Program. On a daily basis, literally thousands of paper notices must be generated on such subjects as new policy issuances, renewals, cancellations, etc. When calls were made to the individuals who actually operate these machines that they needed to be reprogrammed on less than 60-days notice, these people were literally apoplectic. There simply was no way to actually shut

down all of these systems and machines on such short notice, and definitely no way to do it and then restart the operation in a similarly short timeframe. The companies had absolutely no choice but to trust that the Congress would indeed reauthorize the Program, and to continue to issue the policies despite the lack of any statutory authority. (As should be noted, that trust was well placed.)

Clearly, this was a legal problem for the companies. All flood policies state in no uncertain terms that they are issued pursuant to the U.S. Government's National Flood Insurance Program. The unanticipated lack of reauthorization caused the companies to be forced to issue polices that were not actually authorized by the Program. The liabilities that this could have opened up for the carriers had the Program not been reauthorized in such short order, is still a sore subject with the carriers.[12]

The undersigned is not truly in a position to speak in regards to lending institutions. However, he is aware that at some point during the discussions about the lapse of reauthorization, that various banks were strongly considering a complete halt to all loan closings. It was widely stated that if reauthorization did not occur in early January, that a halt to loan closings was exactly what was going to happen. Had that occurred, the housing industry would have come to an abrupt halt.

The National Flood Insurance Program is now intertwined with the housing industry to such an extent that impacting the NFIP necessarily impacts the housing industry. For this reason, and for the purpose of the stability of both the Program and the housing industry, it would be far more preferable if the Program could be reauthorized on terms exceeding two years. The carriers are very

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[12] Several carriers sent out separate notices and took other steps at great expense. Thus far, FEMA has not been willing to reimburse the companies for these expenses.

sensitive to the prospect of what will or will not occur this coming December 31, 2003. They are very wary of having to go through all of the exact same process once again. Hopefully, such can be avoided.

4. Proposals for Reducing Litigation Costs

The principal cost savings being proposed by the undersigned is the rewrite of the jurisdictional statute. This would save the Program a small fortune in unwarranted legal bills, as well as settlements that are made solely because of a lack of confidence in a non-federal forum. Notably, the savings would not be just on those cases where jurisdiction is directly put at issue. When the carriers are able to litigate in a forum where the rules are understood and where enforcement by the court is predictable, then legal bills can be kept to a minimum because the litigation will be efficient, and the only settlements will be those where either it turns out that the benefits are genuinely owed, or a mere cost-of-defense-type settlement entered into for no other purpose than to avoid unnecessary costs of defense.

In addition to the jurisdictional issue, the undersigned believes that he would be less than candid if he did not at least raise, in a general sense, two other issues. These issues are in need of serious scrutiny by FIMA in the first instance. However, it is important that the Committee know that they are out there. The two points to be addressed below are points of immense concern to the companies. Specifically, there are companies that are considering withdrawing from the Program because of the two problems to be described below:

A. A Lack of Communication

At the current time, there is a serious lack of communication between company representatives and FIMA. It should be quickly pointed out that it is well understood that all of the

personnel connected to FIMA and FEMA have had a very full plate as a result of 9/11, as well as from the reorganization of FEMA into the Homeland Security Department. Neither the undersigned nor the carriers are unmindful of the realities of these developments. That having been said, however, we now have approximately 18 months worth of backlog in unfinished business, and in disputed important matters where decisions are absolutely necessary.

In considering this point, please consider that the NFIP is an extremely complicated operating system. It manages approximately one-half *trillion* dollars in risks against the U.S. Treasury. It demands constant attention and the focus of sophisticated management both from the companies, and from FIMA. Just as any large corporation could not survive 18 months without managerial oversight, the NFIP is in need of attention.

It is the understanding of the carriers that it is the intention of FIMA's Administrator to commence meetings with the principal flood coordinators of the various companies within the next few months. Assuming this occurs, it is likely that the company representatives and the FIMA representatives can examine the backlog of issues, debate them thoroughly, reach consensus, and move on.

B. Agent Error

A major philosophical and legal debate has arisen between the companies and FIMA over the role and legal status of the insurance agents who sell flood insurance policies. As of 1999, FIMA and the companies were on the exact same page. FIMA had published to the courts a formal statement of the position of the Agency upon the role and legal status of agents, and the companies are in full agreement with that 1999 declaration. However, since that time, there seems to be a developing 180° change in how the Program views the agents. This is alarming to the companies.

Congress has a prior history on this issue as well. In 1981, Congress enacted a hold harmless agreement providing protection to insurance agents who agreed to participate in the NFIP. That hold harmless agreement is now found at 42 U.S.C. §4081(c) of the Act. In the legislative history to that statute, the following comments by Senator Richard Lugar are available and explain Congress's intention for that statute:

> As I stated in the Congressional record on June 3, 1981, a statutory hold harmless agreement became necessary after an opinion issued by the Comptroller General of the United States voided an earlier agency hold harmless agreement that had been in effect since 1978.
>
> It is my firm belief that nullification of the agreement that shielded insurance agents from sometimes substantial losses caused by the mistakes of others seriously jeopardized the overall success of the flood insurance program. Even apart from the potentially adverse impact of the Comptroller General's opinion, I believe as a matter of simple equity that insurance agent participants in the flood insurance program should not be caused to suffer for the mistakes of others.
>
> The language I offer, and agreed to by the conference committee members, restores a hold harmless agreement to the flood insurance program. As importantly, it restores to the Program the confidence of the many thousands of insurance agents who bring flood insurance to the public. *Congressional Record – Senate*, July 13, 1981, p. 19133

It is presumed that the Administrator will shortly be engaging the carriers in a serious and robust debate of any change in philosophy that places the Program at odds with congressional intent for that hold harmless agreement, or with prior commitments to the carriers. However, it is believed that the Congress should be aware of this controversy, and that there are several carriers who are contemplating ending their participation in the flood program if FIMA decides to take a position that is at odds with this statute, or with FEMA's current regulations and declarations. Hopefully, as with numerous other issues that have been resolved through frank and open debate between the principal representatives of the Government and the carriers, such can be avoided.

RECOMMENDATIONS

The following recommendations are offered for the Committee's consideration:

1. Revise 42 U.S.C. §4072 to make clear that all disputes arising out of participation, or attempted participation, in the NFIP must be filed in the federal courts. Doing so will allow for the development of a uniform body of case law across all of the states for all Program issues, allowing all persons who seek the benefit of the Program to know precisely where they stand on all issues. The result will be greater efficiency, greater predictability in the law, and lower overall costs. It would also validate the positions taken by key states that have a great interest in the continued success of the Program.

2. Consider reauthorizing the Program for terms exceeding two years, for the purpose of attaining the stability that this achieves for everyone concerned.

3. Be aware that the difficulties experienced by FIMA over the past 18 months have not been without impact to the normal operation of the NFIP. It is important that FIMA officials be allowed to get back into a structure where they can focus on the Program's serious operational issues.

4. Ask that FIMA provide information to the Congress if indeed it does intend to alter its previously-published views on the role of insurance agents in the Program, particularly if any such decisions implicate 42 U.S.C. §4081(c).

Respectfully submitted,

Gerald J. Nielsen

STATE OF SOUTH CAROLINA)
)
COUNTY OF RICHLAND)

COMES NOW, the affiant, duly sworn, who deposes and says as follows:

1. My name is Ernst N. Csiszar, and I am the duly appointed Director of Insurance for the State of South Carolina. In this capacity, I supervise the South Carolina Department of Insurance's regulation of the insurance industry. I am familiar with the National Flood Insurance Program (NFIP), as well as the Standard Flood Insurance Policy, which is issued by the Federal Emergency Management Agency (FEMA) through insurers who participate with FEMA in a program known as the Write-Your-Own Program of the NFIP.

2. The purpose of the Write-Your-Own Program is to assist an insurer in underwriting flood insurance using the Standard Flood Insurance Policy. Over time, the Write-Your-Own Program is designed to increase industry participation, and accordingly, reduce or eliminate the U.S. Government as the principal vehicle for delivering flood insurance to the public.

3. The Federal Insurance Administration (FIA) and FEMA enforce the policy issuance and marketing provisions of the Write-Your-Own Program. FEMA is responsible for the dissemination of information pertaining to the NFIP, including premium rates. *See* 42 USC § 4020. In this regard, the marketing of NFIP policies is regulated by FEMA (*See 44* CFR Part 62, Appendix A, Article II D-G), and not by the State of South Carolina. NFIP claims are also handled by those agencies. All claims processing must be in accordance with the processing of all the companies' insurance policies and with the Financial Control Plan and with FIA's Policy Issuances and other guidance authorized by the FIA and FEMA. *See* Financial Assistance/Subsidy Arrangement, Appendix A-Part 62. In situations where a South Carolina consumer has an NFIP claims dispute, this Department assists that consumer by referring him to the appropriate Federal agency, the FIA.

FURTHER, the affiant sayeth not.

Ernst N. Csiszar
Director of Insurance
State of South Carolina

Sworn to before me this
4 day of October, 2001.

My commission expires: May 10, 2009

AFFIDAVIT

STATE OF NORTH CAROLINA

COUNTY OF WAKE

Before me, the undersigned Notary Public, duly commissioned and qualified, personally came and appeared JIM LONG, who upon being duly sworn did depose and state based upon his own personal knowledge the following:

1. I am the duly elected Insurance Commissioner of the State of North Carolina. As such I am personally familiar with the policies and practices of the North Carolina Department of Insurance, as well as the laws of the State of North Carolina regulating insurance carriers who issue insurance policies within this State. In addition, I am familiar with the U.S. Government's National Flood Insurance Program (NFIP), as well as the Standard Flood Insurance Policy, which is issued by the Federal Emergency Management Agency (FEMA) through insurance companies who participate with FEMA in a program known as the "Write-Your-Own" Program of the NFIP.

2. The North Carolina Department of Insurance does not regulate the Standard Flood Insurance Policy issued pursuant to the NFIP. The North Carolina Department of Insurance takes the position that the North Carolina Department of Insurance does not have jurisdiction over an insurer issuing a SFIP under the NFIP. Moreover, it is the position of the North Carolina Department of Insurance that the provisions of Chapter 58 of the North Carolina General Statutes (the North Carolina Insurance Law) do not apply to an insurer issuing a SFIP under the NFIP.

3. The North Carolina Department of Insurance has no jurisdiction or regulatory control over how claims against a SFIP are adjusted by FEMA's "Write-Your-Own" Program carriers. All such claims disputes are regulated by the Federal Insurance Administration, as such disputes concern whether a claim against a U.S. Treasury-underwritten SFIP was properly handled by FEMA's "Write-Your-Own" Program carrier. Congress has expressly vested all such authority in FEMA. See

(CONTINUED)

AFFIDAVIT OF JIM LONG
JANUARY 19, 2001
PAGE 2

42 U.S.C. §4019. In circumstances where a citizen of the State of North Carolina turns to the North Carolina Department of Insurance for assistance with such a claims dispute, the only involvement of the North Carolina Department of Insurance is to assist that citizen by referring the citizen to the appropriate federal regulatory agency, that being the Federal Insurance Administration in Washington, D.C.

Further, Affiant sayeth not.

Jim Long

JIM LONG, Insurance Commissioner of
the State of North Carolina

January 19, 2001
DATE

SWORN TO AND SUBSCRIBED

BEFORE ME THIS 19th DAY OF

January, 2001.

Mary Faulkner
Notary Public
My commission expires 6/27/01

AFFIDAVIT OF LARRY DUNBAR

STATE OF TEXAS §
§
COUNTY OF TRAVIS §

Before me, the undersigned notary, on this day, personally appeared Larry Dunbar, a person whose identity is known to me. After I administered an oath to him, upon his oath, he said:

1. "My name is Larry Dunbar. I am of sound mind and capable of making this Affidavit. I have personal knowledge of the facts stated in this Affidavit, and they are true and correct.

2. I am the Manager of the Homeowners Division of the Texas Department of Insurance. In this capacity, I am familiar with the standard Texas homeowners policies prescribed by the Texas Department of Insurance ("TDI"). As part of my job duties, I commonly deal with the TDI's regulation of the standard Texas homeowner's policies and the insurance carriers issuing those policies. I am familiar with the TDI's regulation of this industry.

3. As the Manager of the Homeowners Division, I am also knowledgeable as to whether the TDI would regulate a Standard Flood Insurance Policy ("SFIP") under the National Flood Insurance Program or an insurer issuing a SFIP. I am aware that the TDI does not regulate the SFIP under the National Flood Insurance Program. Further, in my job capacity, I know that the TDI takes the position that the TDI does not have jurisdiction over an insurer issuing a SFIP under the National Flood Insurance Program. Further, I am aware that it is the TDI's position that the provisions of the Texas Insurance Code do not apply to an insurer issuing a SFIP under the National Flood Insurance Program."

FURTHER, AFFIANT SAYETH NOT.

Larry Dunbar

SUBSCRIBED AND SWORN TO before me by Larry Dunbar on this 25th day of February, 2000 to certify with witness my hand and seal of office.

Notary Public in and for the State of Texas

My Commission Expires:

1-20-2001

JAMES M. NIXON
NOTARY PUBLIC
State of Texas
Comm. Exp. 01-20-2001

STATE OF MISSISSIPPI)
)
COUNTY OF HINDS)

COMES NOW, the affiant, duly sworn, who deposes and says as follows:

1. My name is George Dale, and I am the duly elected Commissioner of Insurance for the State of Mississippi. In this capacity, I supervise the Mississippi Department of Insurance's regulation of the insurance industry. I am familiar with the National Flood Insurance Program (NFIP), as well as the Standard Flood Insurance Policy, which is issued by the Federal Emergency Management Agency (FEMA) through insurers who participate with FEMA in a program known as the Write-Your-Own Program of the NFIP.

2. The purpose of the Write-Your-Own Program is to assist an insurer in underwriting flood insurance using the Standard Flood Insurance Policy. Over time, the Write-Your-Own Program is designed to increase industry participation, and accordingly, reduce the U.S. Government's role as the principal vehicle for delivering flood insurance to the public.

3. The Federal Insurance Administration (FIA) and FEMA enforce the policy issuance and marketing provisions of the Write-Your-Own Program. FEMA is responsible for the dissemination of information pertaining to the NFIP, including premium rates. See 42 USC § 4020. In this regard, the marketing of NFIP policies is regulated by FEMA (See 44 CFR Part 62, Appendix A, Article II D-G), and not by the State of Mississippi. NFIP claims are also handled by those agencies. All claims processing must be in accordance with the processing of all the companies' insurance policies and with the Financial Control Plan and with FIA's Policy Issuances and other guidance authorized by the FIA and FEMA. See Financial Assistance/Subsidy Arrangement, Appendix A-part 62. In situations where a Mississippi consumer has an NFIP claims dispute, this Department assists that consumer by referring him to the appropriate Federal agency, the FIA.

FURTHER, the affiant sayeth not.

George Dale
Commissioner of Insurance
State of Mississippi

Sworn to before me this
[illegible] day of February, 2002

My commission expires: MISSISSIPPI STATEWIDE NOTARY PUBLIC
MY COMMISSION EXPIRES FEB. 1, 2005
BONDED THRU STEGALL NOTARY SERVICE

Testimony of

America's Community Bankers

on

National Flood Insurance Program, and
FEMA's Repetitive Loss Mitigation Strategy

H.R. 253 and H.R. 670

before the

Subcommittee on Housing and Community Opportunity

of the

Financial Services Committee

of the

United States House of Representatives

on

April 1, 2003

Frederick Willetts, III
Chairman, President and CEO
Cooperative Bank
Wilmington, North Carolina

Good afternoon. Chairman Ney, Ranking Member Waters, and Distinguished Members of the Committee, thank you for the opportunity to testify at today's hearing on the National Flood Insurance Program (NFIP) and specifically on the Federal Emergency Management Agency's (FEMA) repetitive loss mitigation strategy and multi-year reauthorization of the NFIP.

My name is Frederick Willetts III. I am President and CEO of Cooperative Bank in Wilmington, North Carolina. Cooperative Bank is a state chartered commercial bank with total assets of $500 million. The bank and it's subsidiary operate 20 offices from Virginia Beach, Virginia to Myrtle Beach, South Carolina. I am testifying today as a member of America's Community Bankers (ACB). ACB's member banks originate more than 25 percent of all mortgages in the United States, and significantly more than half of all mortgages originated by depository institutions. In addition, our members operate a large number of mortgage banking affiliates that originate a substantial part of the business from that segment of the industry.

The NFIP is important to every mortgage lender in the United States whose lending territory includes properties in areas of high flood risk. ACB members and their customers have come to rely on the NFIP as a primary source of affordable flood insurance. As a result, we would like to focus our remarks on the impact of these bills on our members and their customers.

Thank you for the opportunity to testify today on this important program.

ACB's Positions

We support attempts by FEMA, the Administration, and Congress to begin to stem the costs to taxpayers associated with repetitive loss properties. However, it is vital that any such efforts protect mortgage lenders to the extend possible by giving them advance notice of any actions that would impair the ability of the homeowner to repay the mortgage or recoup the value of the property. Also, Congress must clarify that it does not intend to treat as repetitive loss properties those that have experienced losses not expected to be recurrent.

Additionally, ACB believes that any bill to revise the NFIP must include a multi-year extension of NFIP authorization.

Explanation

H.R. 253—"Two Floods and You are Out of the Taxpayer's Pocket Act" and H.R. 670—"Flood Loss Mitigation Act"

Repetitive Loss Properties

H.R. 253 and H.R. 670 propose a two-pronged approach to curtail excessive government subsidies on repetitive loss properties. First, the bills would increase funding and

improve procedures for mitigating losses under the NFIP. For many years, FEMA has endeavored to mitigate repetitive losses through various strategies, including the purchase, relocation, and elevation of properties that have experienced repetitive losses. The funds available for such mitigation efforts have been limited. Both bills would provide additional financing for FEMA's loss mitigation strategy.

Second, each bill would put some responsibility on property owners to bear the cost of not accepting the government's buyout or mitigation offers. The bills impose these responsibilities in different ways. H.R. 253 would require property owners to pay actuarial rates for their flood insurance and would make repetitive loss policyholders ineligible for federal disaster relief assistance if they refuse mitigation measures. H.R. 670 provides that policyholders who refuse mitigation assistance could face higher premiums or cancellation of NFIP policies.

ACB supports increased flood insurance premiums under the circumstances identified in the bills as a way of making property owners take additional responsibility to prevent multiple claims. However, we think the bills should take into account circumstances that might unduly imperil the homeowner, the lender, or other affected parties.

Specific Policy Concerns Regarding Mortgage Lender Protection

Termination of flood insurance or large increases in premiums will have significant consequences for homeowners and lenders that have financed their home purchases. It has been estimated that the average annual flood insurance premium assessed for targeted properties would increase from approximately $600 per year to $10,000 per year. Such an increase would not only represent a financial hardship on the property owner (perhaps beyond his or her capacity to pay), it also likely would affect the value and marketability of the property.

The mortgage lender who extended credit based upon the borrower's ability to pay and the property's market value should be notified formally of the planned premium increase in advance and at a time when intervention might still be possible. For similar reasons, prospective purchasers and mortgage lenders should also be made aware of the proposed premium increase.

There are also situations where a lender's collateral would be put at great risk by a mitigation buy-out offer. A key objective of H.R. 670 and H.R. 253 is to dramatically expand FEMA's current efforts to acquire properties and relocate families out of areas prone to repeat flooding. Unlike a traditional property sale, however, FEMA's goal is not to preserve the structure, but to demolish it. As a result, lenders' collateral is put at risk. Lenders' deserve some assurances that any loan secured by a property targeted for demolition will be repaid with the proceeds of the buyout. As a result of this concern, we recommend that the bills provide for notice to the mortgage lender or servicer of a buyout offer made under the mitigation program.

We believe there are circumstances in which homeowners should not be required to accept a buyout offer under the mitigation program. H.R.670 makes this exclusion in the following instances: (1) the homeowner would be unable to purchase a replacement structure; (2) flood damage was caused by a third party; (3) the property was historically significant; or (4) the property was not located in a Special Flood Hazard Area at the time of purchase. H.R. 670 further grants the Director of FEMA the authority to provide other exemptions.

ACB supports these exemptions and would like to recommend that an additional exemption be added. We request that consideration be given to excluding purchase offers that are insufficient to pay off the outstanding balance on mortgages secured by these properties. We do not believe homeowners should be penalized for refusing buyout offers when the mortgage balance exceeds the purchase offer. Homeowners should not have their flood insurance cancelled, premiums significantly raised, or be made ineligible for disaster relief because the property value has declined significantly since it was purchased.

Again, we believe there are numerous reasons why a buyout or mitigation offer is not the best solution in all instances. Therefore, we support the appeals concept found in H.R. 670, which allows homeowners to appeal a decision to cancel flood insurance or increase the insurance rates.

In addition, ACB believes it is essential for Congress to clarify that it does not intend flood insurance coverage be denied to properties in broad geographic areas that might experience large number of losses as an aberration. For instance, under the bills, specific property owners and those in limited, designated areas might be denied flood insurance coverage, or charged higher premiums, if they have multiple claims in certain time periods and have refused mitigation assistance. Such denials might occur for a property on a point of land on a coastal bay, or a neighborhood at the confluence of two rivers.

ACB does not view the bills as applicable to potential denials of coverage in broad geographic regions. For instance, the region in which I live, coastal Carolina, has recently experienced an unusually large number of hurricanes, one of which resulted in a 500-year flood. It would not be practicable for FEMA to respond to such circumstances by seeking extensive mitigation or relocation. Such actions would be neither practicable nor warranted, be they for coastal Carolina, Louisiana, or Texas, or perhaps for entire river systems. It is essential that Congress clarify the expected scope of circumstances under which FEMA might deny, cancel or otherwise change the availability of flood insurance under the bills as proposed to avoid such unintended applications of any statutory change.

Implications for Lapse in NFIP Statutory Authority

H.R. 253 also would extend the authorization of the NFIP until 2007, which ACB strongly supports._Under the NFIP, financial institutions are prohibited from originating

or refinancing loans secured by property in Special Flood Hazard Areas unless covered by flood insurance. Federal financial institutions, agencies, and FEMA each have adopted regulations requiring lenders to compel compliance with mandatory flood insurance purchase requirements for residential properties in NFIP participating communities. Lenders must first determine if the structure is located in a Special Flood Hazard Area, and then must provide written notice to property owners requiring flood insurance.

The lack of NFIP authorization at the beginning of the 108th Congress could have caused significant disruption to property owners whose policies were not issued or renewed before December 31, 2002. During the lapse in authorization, FEMA estimates that approximately 400,000 households may have been prevented from obtaining or maintaining insurance, and those seeking home loans or mortgage refinancings that require flood insurance as a precondition to settlement might have been delayed or prevented from completing their transactions.

To avoid such problems in the future, ACB advocates a multi-year extension of NFIP authority for a period of at least four or five years.

Conclusion

ACB looks forward to working with FEMA on solutions to make the NFIP a beneficial program to all entities.

STATEMENT OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

April 1, 2003

Good afternoon Chairman Ney and Members of the Subcommittee. My name is Fletcher Willey and I am pleased to have the opportunity to give you the views of the Independent Insurance Agents and Brokers of America (IIABA) on the National Flood Insurance Program ("NFIP" or the "Program"). I am a member of the Government Affairs Committee of the IIABA and Chair its Flood Insurance Task Force. IIABA is the nation's oldest and largest national trade association of independent insurance agents, and represents a network of more than 300,000 agents and agency employees nationwide. IIABA members are small businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents offer all lines of insurance – property, casualty, life, health, employee benefit plans and retirement products.

Introduction

Let me begin by stating clearly that IIABA supports the NFIP. NFIP provides an important service to people and places that have been hit by a natural disaster. The private insurance industry has been, and continues to be, almost entirely unwilling to underwrite flood insurance because of the catastrophic nature of these disasters. Therefore, NFIP is virtually the only way for people to protect against the loss of their home or business. 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, NFIP has saved disaster assistance money and provided a more reliable system of payments for people whose properties have suffered flood damage. It is my understanding that since 1986, no taxpayer money has been used to support the NFIP, rather the NFIP has been able to support itself using the funds from the premiums it collects ever year. We want the Program to continue and we hope it will get stronger.

Our members -- independent insurance agents and brokers -- play a vital role in the delivery system for flood insurance. The NFIP has about three and one-half million policies in force with over $370 billion in coverage. The majority of these policies are sold by the more than 110,000 insurance agents participating in NFIP's "Write Your Own" program. This system operates well and does not need revision.

IIABA has not yet taken a position on the bills (H.R. 253, H.R. 670) that are the subject of today's hearing. It is clear, however, that reforms of the Program are necessary to address operating losses and make the NFIP actuarially sound. The premium structure is not sufficient to allow the Program to build up reserves to cover long-term expected losses. According to GAO,

multiple loss properties (defined as those with two or more losses over $1,000 each in a 10-year period) account for about $200 million in claims per year and about 36% of all claims paid on a historical basis.

What I would like to do this afternoon is explain the five principles that IIABA believes must animate any NFIP reform efforts to both improve the Program and avoid any unintended negative effects of reform:

- Strengthen NFIP building regulations
- Increase compliance with the mandatory purchase requirement
- Provide additional resources for flood loss mitigation efforts
- Stop abuse of the Program through multiple claims
- Require mandatory disclosures of flood information

While we support the NFIP, we recognize that there is need for reform to make the program actuarially sound. We hope that we will be able to work with the Subcommittee as you evaluate the different proposals for reform to meet the fiscal goals of the Program with the least amount of disruption to people's lives as possible. Our members have significant experience with the NFIP and with the people who will be directly affected by reform -- flood insurance policyholders. In fact, this is not just a professional matter for me; I live on Roanoke Island, which is in a flood plain in North Carolina, and have flood insurance so I have some degree of personal experience and personal investment in this issue.

1. Strengthen NFIP Building Regulations

The first principle that IIABA believes should be part of any reform of the NFIP is strengthened NFIP building regulations. The building regulations help communities better manage their floodplains in two ways. First, the regulations require communities to ensure that any new construction in floodplains includes safeguards against flood damage such as building new homes above the flood elevation on pilings. Second, the regulations require that any substantial improvements made to existing buildings in the floodplain incorporate safeguards similar to those required for new construction.

Experience with the Program demonstrates that the building regulations work. The majority of flood losses are caused by damage to older homes. In fact, only four percent of repetitive loss properties were built after 1974. In 1999, the Federal Insurance Administration estimated that the Program's construction standards were saving $1 billion per year. Structures that are built to the Program's standards are three and one-half to four times less likely to suffer flood losses. In addition, the damages to structures built to these standards are 40% less per claim than the damages to older structures.

In light of this success, building requirements should be tightened to ensure that properties are built to minimize potential flood damage and to discourage unwise construction in flood plains.

2. Increase Compliance with the Mandatory Purchase Requirement

NFIP would receive additional premiums and improve its financial condition if there were a better rate of compliance with the mandatory flood insurance purchase requirement. In 1973, the purchase of flood insurance became mandatory for any property in a floodplain having a one percent or greater chance of flood occurrence in a given year. The purchase requirement takes effect when a loan is made, increased, extended or renewed on the property. The Federal Emergency Management Agency ("FEMA") has found that fewer than twenty five percent of buildings in areas covered by the mandatory purchase requirement are actually covered by flood insurance. And compliance rates vary dramatically. Based on past disasters, coverage has ranged from less than ten percent to seventy five percent of eligible properties. In fact in my own state of North Carolina, following Hurricane Floyd, in which 66 of the 100 counties were declared disaster areas, only 13% of the 67,000 homes that incurred flood damage actually had flood insurance. Sanctions for and enforcement of the mandatory purchase requirement need to be improved so that the Program can collect additional premium to help balance its books, and fund the payment of future losses with a reduced likelihood of having to borrow from the federal treasury. HABA also proposes that insurance companies be made to inform their customers that flood insurance is not covered in their standard homeowner's policy, and if they are in a flood zone, it is mandatory that they must purchase such coverage.

3. NFIP Should Have Additional Resources for Mitigation

NFIP should take action to prevent future losses. There are two basic ways to do this. The first is through buying the homes and businesses of property owners in the most flood-prone areas so that those individuals can move out of the floodplain. The second is through providing grant funds to owners of existing properties so that they can make improvements (such as raising their structures) that decrease the risk of flood loss. These preventative measures will decrease the number of repetitive claims and save the Program money.

Repetitive loss properties are clearly a drain on the financial resources of the NFIP. In fact, one-quarter of one percent of the properties in the Program are responsible for 10 percent of the losses. Multiple loss properties account for $200 million per year in claims. As of 1999, GAO reported that the cost of multiple claims had reached $2 billion over the life of the NFIP. GAO also noted that about 40,000 properties that had made multiple claims were still insured by the Program. This can be accomplished through grants to buy-out property owners or modify structures to come into compliance with NFIP standards.

I can tell you many stories about the need for mitigation funds. I myself have been able to avoid flood losses because my home is elevated so I know from first-hand experience that mitigation efforts can work. The Athletic Director of my local high school, however, also lives in the floodplain -- about one-half of a mile from me. His home has been hit by flooding repeatedly -- 5 times since 1987. The losses have pushed him to the point of bankruptcy. He would like nothing better than to get the money to elevate his home or sell, but the Program does not have the funds to help him. Examples like this exist in virtually every community that has been hit by floods.

Buy-outs allow residents to relocate outside the floodplain and prevent future losses. Of course, we must be sensitive to the needs of residents when using buy-outs. Many residents bought their

homes before we had full information about the floodplains. The value of many of these homes also may not be sufficient to allow homeowners to relocate to a comparable home. We should avoid creating a new problem by pushing residents out of their homes without sufficient resources to relocate.

As long as the Program is sensitive to the potential dangers, buy-outs can be beneficial tools to improve the financial state of the NFIP. Former FEMA Director James Lee Witt has estimated that there will be a $2 return on every $1 spent on buy-outs of repetitive loss properties. That is an impressive return on investment that we should maximize by putting more money into the Program for buy-outs. Past efforts have proved that mitigation works. Damage to towns along the Mississippi River following the 1993 floods were huge -- $67 million in Wisconsin, $251 million in Iowa and $253 million in Illinois. This year's flood carried about as much water in some areas as in 1993, but, according to the Washington Post, preliminary damage estimates in those three States is only $30 million total. Overall damage from the 1993 flood was more than $10 billion, but this year it is expected to be less than 5 percent of that. While some of those savings are attributable to differences in the floods, a lot of it is because people and towns were bought out and moved.

NFIP also should have additional resources for structural modification of properties to prevent losses. Many residents do not want to move and should not be forced to do so. Experience with the NFIP building standards has shown that many owners can elevate their homes or businesses and effectively reduce flood risks. In some cases, modifying the current property is less expensive and equally (or almost as) effective as a buy-out. And this option can help preserve communities to the fullest extent possible. NFIP needs the authority and resources to help property owners improve their properties before the Program suffers additional losses.

4. Stop Abuse of the Program Through Multiple Claims

We need to do more to stop the abuses of the Program. Some individuals have bought in flood zones in order to take advantage of repeat payments from the NFIP. While the people in this category are a small minority of all property owners, they are an expensive minority. There must be some mechanism to either remove these individuals from the Program or make them pay the full, unsubsidized premium based on sound actuarial standards. This type of approach would be similar to the limitations put on the crop insurance Program in which farmers who file numerous, repetitive claims again are put in a special "high risk, non-classified" system with increased rates and less than full guarantees. Simply reducing abuse of the system will be an important boost to the financial soundness of NFIP.

We also need to recognize that not all repeat claimants are abusing the system. The majority of these people are the victims of natural disasters and bought their homes or businesses without any desire at all to make a claim for flood damage. These are difficult events in people's lives and they should not be punished for them. Many bought without full knowledge of the flood risk to their property and many more do not have the resources to elevate their properties or move. And many of these individuals cannot sell their homes for a reasonable price because they have suffered repeat flood damage -- these folks are stuck in the Program through no fault of their own. They need to be given mitigation options to enable them to escape this nightmarish cycle.

5. Require Mandatory Disclosures of Flood Information

One of the best ways to avoid future problems with the NFIP is to give people information about flood risks. As I said before, many people originally bought their properties without knowledge of the risk of flood. Reform of the NFIP needs to include mandatory disclosures of the flood history of the property so that buyers can make an informed choice in their purchases and they can properly value the home. To make mandatory disclosure effective, we should create an accessible electronic database of flood losses. Disclosure of flood information will help ensure that when a tragedy strikes in the future NFIP does not have to pay for an artificially overvalued property. The disclosure also should bring more people into the Program by giving them the information about their risks.

Finally, IIABA along with FIPNC, a coalition of agent groups and "Write Your Own Carriers", is asking congress to change the reauthorization period from one year to five years. Last year, Congress adjourned without reauthorizing the NFIP program. This put the program in limbo, and left the industry and more importantly consumers not knowing when or if the program would be reauthorized and wondering how they should proceed in the meantime. Thankfully Congress reacted swiftly and passed a reauthorization bill the first week they returned from recess. However, those two weeks of uncertainty, caused a great deal of panic in the market, and had the potential to freeze the entire real estate market, as consumers need flood insurance to be able to close on a mortgage. We strongly recommend that Congress both change the reauthorization period to five years, and change the expiration day from the end of the year to another time, as to avoid having the program expire at the same time as Congress is adjourned.

* * *

Thank you for giving me the opportunity to express IIABA's views. We look forward to working with the Subcommittee on this issue and I will be happy to take any questions you may have for me.

The Premier Association of Real Estate Finance

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Statement by the Mortgage Bankers Association of America

for the

Hearing on The National Flood Insurance Program:

Review and Reauthorization

on

Tuesday, April 01, 2003

at the

Subcommittee on Housing and Community Opportunity

House Financial Services Committee

Statement by the Mortgage Bankers Association of America
Hearing on the National Flood Insurance Program: Review and Reauthorization

Subcommittee on Housing and Community Opportunity
House Financial Services Committee

April 1, 2003

The Mortgage Bankers Association of America (MBA) is pleased to have this opportunity to testify on the National Flood Insurance Program (NFIP). We applaud the House Housing Subcommittee for holding this hearing and for your willingness to discuss reform and reauthorization of this important program. MBA' s comments will focus on the value of the NFIP, the need for multi-year reauthorization of the NFIP, and legislation recently introduced, H.R. 670, the "Flood Loss Mitigation Act of 2003" introduced by Congressman Richard Baker (R-LA) and H.R. 253, "Two Floods and You Are Out of the Taxpayers' Pocket Act of 2003" introduced by Congressmen Doug Bereuter (R-NE) and Earl Blumenauer (D-OR), which are both designed to mitigate repetitive loss claims.

MBA is a trade association representing approximately 2,600 members involved in all aspects of real estate finance. Our members include national and regional lenders, mortgage brokers, mortgage conduits, and service providers. MBA encompasses residential mortgage lenders, both single-family and multifamily, and commercial mortgage lenders. Our members and their customers have come to depend on the NFIP as a primary source of affordable flood insurance. There are approximately 4.4 million NFIP policies currently in force. It is estimated that 80 percent of those properties are mortgaged.

Over the years, the nationwide availability of affordable flood insurance has been critical to improving home ownership and affordability. The NFIP serves a very important function in the mortgage lending industry as it reduces the overall cost of financing a home located in a flood prone area by providing affordable and reliable flood insurance. Even before the statutory mandatory purchase requirement, lenders required flood insurance to protect their collateral interests. With the passage of the National Flood Insurance Reform Act of 1994 (NFIRA), the importance of the NFIP has increased as it is now unlawful to originate a loan on a property located in a Special Flood Hazard Area (SFHA) without flood insurance coverage for the life of the loan. Without a reliable and uninterrupted source of flood insurance, we believe mortgage credit would – at best -- be more expensive or -- at worst -- unavailable in many markets.

Although there are private providers of flood insurance, it is estimated that 90 percent of all flood policies are written through the NFIP. With this in mind, MBA strongly supports multi-year NFIP authorization.

Multi-year NFIP Authorization

Last year the mortgage lending industry faced a crisis. The Federal Emergency Management Agency's (FEMA) authority to enter into new contracts for flood insurance was set to expire on December 31, 2002. After that date, no new NFIP flood insurance policies could be written until Congress reauthorized the program in mid-January, at the earliest. There was no doubt, the NFIP authority would lapse.

Due to NFIRA's mandatory purchase requirement, mortgage lenders were concerned they would be prohibited from originating mortgages on properties located in SFHAs during the hiatus. Many feared lending would come to a virtual halt in flood prone markets. For borrowers, such an outcome would have been devastating. Borrowers scheduled to close on real estate during the hiatus could have lost their loan commitments and the right to purchase the properties.

Fortunately, the federal agencies, investors, and 108th Congress reacted quickly. FEMA and the federal bank regulatory agencies -- which enforce NFIRA for federal financial institutions -- clarified that the unavailability of NFIP-provided flood insurance relieved lenders of the mandatory purchase requirement. Fannie Mae, Freddie Mac, the Federal Housing Administration and the Department of Veterans' Affairs further stated that they would continue purchasing, insuring and guaranteeing properties without flood insurance during the hiatus.

Statutory compliance was not the only hurdle lenders had to surmount in order to continue to make loans on flood prone properties. Lenders and investors were uncomfortable with the possibility of having a large portfolio of uninsured loans. The longer the lapse remained unresolved, the more risk these entities faced that a disaster would strike and funds would not be available to repair or replace the properties. As a result, some investors set specific deadlines after which purchases could be halted. Fortunately, H.R. 11, the National Flood Insurance Program Reauthorization Act of 2003, passed on January 8, 2003, before the expiration of these deadlines. The anticipated retroactive coverage provided in H.R. 11 was also instrumental in providing an uninterrupted flow of mortgage funds during the hiatus. MBA applauds this Congress, and especially the House Financial Services Committee, for elevating the importance of this issue and passing H.R. 11 in such a prompt manner.

Nonetheless, a valuable lesson was learned from this experience. Multi-year authorization for the NFIP is critical. We, therefore, support the provision in H.R. 253, which calls for the reauthorization of the NFIP until December 31, 2007. Multi-year reauthorization will lessen possible disruption to borrowers and lenders in the future.

Mitigation of Repetitive Loss Properties: H.R. 670 and H.R. 253

One of the key purposes of today's hearing is to debate various reform proposals for FEMA's repetitive loss concerns. Repetitive losses are a serious issue for both property owners and the NFIP. According to FEMA, approximately $4.4 billion of the $11 billion in flood insurance claim payments, over the life of the program, have been made to repetitive loss properties. Historically, there have been 95,000 properties that have been subject to repetitive flooding, of which 46,000-48,000 are currently NFIP-insured. While repetitive loss properties make up only 2 percent of the properties historically insured by the NFIP, 40 percent of claims paid to date have gone to these policyholders. In some cases, FEMA paid out more in insurance claims and other assistance than these properties are worth. In fact, approximately 10,000 – 11,000 properties currently insured through the NFIP have had four or more flood losses or have had multiple losses that equaled or exceeded the current insurable value of the property.

For years, FEMA has undertaken efforts to mitigate repetitive losses through a variety of strategies, including the purchase, relocation and elevation of properties that have been subject to multiple flood damage. Today, funding for mitigating repetitive loss structures comes primarily from three FEMA grant programs, including the Hazard Mitigation Grant Program, the Flood Mitigation Assistance Program and the Pre-Disaster Mitigation program. These programs have already offered many families the opportunity to move to non-flood areas or to elevate their properties above the flood level. Funding for these programs, however, is somewhat unpredictable, limited in amount and, in some cases, tied to disaster events.

Both H.R. 670 and H.R. 253 will go a long way to provide additional and more consistent funding for FEMA's Loss Mitigation Strategy. In the remainder of our testimony, we would like to discuss various provisions of the two bills and make some recommendations specific to repetitive loss properties that are secured by mortgages.

Penalties for Refusing Mitigation Offers Under H.R. 670 and H.R. 253

To date, mitigation offers to homeowners are voluntary and do impose significant penalties on homeowners who do not accept them. H.R. 670 and H.R. 253 expand current mitigation strategies by imposing greater responsibilities or "penalties" on property owners who refuse FEMA-funded mitigation offers. The bills impose penalties in different ways. H.R. 253 would require property owners to pay actuarial rates for flood insurance and would make repetitive loss policyholders ineligible for federal disaster relief assistance if they refuse mitigation measures. H.R. 670 would impose higher premiums or cancellation of NFIP policies if homeowners refuse mitigation efforts. These penalties would have serious repercussions for homeowners, as well as, lenders.

Denial or cancellation of federal flood insurance is an extreme measure that could have damaging consequences for homeowners who abide by current rules. In a worse case scenario, a homeowner could face a non-monetary default under the terms of the mortgage (allowing the lender to call the debt due) for failing to maintain insurance for the life of the loan as required by NFIRA. Assuming private insurance was also unavailable, the property would be virtually unmarketable, as buyers would be unable to finance the purchase without insurance.

Increasing insurance premiums to the actuarial rate, on the surface, appears reasonable. However, adoption of this policy could result in a 10-fold premium increase on repetitive loss properties, making it impossible for many to afford their homes. For example, a pre-FIRM structure with total flood coverage of $150,000 is currently subject to a subsidized premium of $590 a year. The same property, if subject to the post-FIRM rate structure, would incur an annual premium of $2,200 if the lowest floor were 2 feet below regulatory flood level; $5,875 if 5 feet below flood level; and $17,050 if 8 feet below flood level. Because the majority of mortgaged properties have flood insurance premiums escrowed, the increase in premium would be annualized and added to the monthly mortgage payment. The borrower's inability to pay the higher monthly payment would result in a monetary default and loss of the property. Lenders would be left with a devalued, unmarketable asset.

Denial of disaster relief would be equally traumatic, especially for borrowers who simply cannot relocate for a variety of reasons. Assuming a repetitive loss property could even be identified, lenders would most likely curb lending on these properties. Moreover, lenders' existing loan portfolios would be at greater risk of loss because federal funds would be unavailable to repair the collateral.

Both homeowners and lenders are affected by these penalties. MBA believes it is critical that additional research be conducted to examine the specific impact of any penalty that might be tied to a homeowner's refusal to accept a buyout or other mitigation offer. The research should also examine whether other adjustments could be made to the Mitigation Grant Programs that would lessen any financial hardship on homeowners.

Our greatest concern is that the penalties described in H.R. 253 and H.R. 670 would put homeowners in a Catch-22 position. If the homeowner does not accept a mitigation offer, the penalty will be so severe as to cause the borrower to default or to be left with an unmarketable property. Conversely, if the homeowner accepts the offer it will result in financial hardship or losses.

Exemptions from Penalties for Failing to Accept a Mitigation Offer

In most cases, homeowners would welcome buyout, relocation and mitigation offers as a way to resolve the devastating financial and emotional results of

repeated flooding. There are homeowners, however, who cannot or should not have to accept a buyout, relocation or other offer for a variety of legitimate reasons. We are pleased, therefore, that H.R. 670 recognizes circumstances where a buyout would be inappropriate or undesirable. H.R. 670 specifically mentions the following situations: (1) the homeowner would be unable to purchase a replacement structure; (2) flood damage was caused by a third party; (3) the property was historically significant or otherwise important to the cohesive structure of a neighborhood; or (4) the property was not located in a SFHA at the time of purchase. H.R. 670 further grants FEMA the authority to provide other exemptions.

In addition to those situations outlined in H.R. 670, MBA recommends two additional situations that may warrant repeal of any penalty for refusal of a mitigation offer: First, homeowners should not be held accountable for refusing buyout or relocation offers where the mortgage balance exceeds the amount of the mitigation offer. Second, homeowners should not face penalties for refusing a mitigation offer that requires the homeowner to subsidize a significant portion of offer. These exemptions should not make a property ineligible for a mitigation option, as some owners may wish to take an offer regardless of the cost. The exemptions should, however, stop the penalties from accruing on the property.

- Exemption for Certain Mitigation Offers that Are Insufficient to Pay Off the Mortgage Debt

In addition to the emotional attachment most homeowners have to their properties, the homeowner will need to evaluate whether acceptance of a buyout or relocation offer will require the homeowner to liquidate assets or savings to pay off the mortgage. Homeowners should not be placed in a position of having flood insurance cancelled, premiums drastically increased or eligibility for disaster relief denied because property values declined or the offer is simply insufficient to cover the debt. Putting property owners in a deficiency situation would be counterproductive to a program clearly designed to assist them. Moreover, strapping homeowners with higher flood insurance premiums during a time of market value decline will only put more pressure on borrowers to sell at a loss. As a result, MBA respectfully requests that legislative proposals not impose penalties on property owners where the purchase or relocation offer is insufficient to pay off the mortgage.

- Exemption for Certain Mitigation Offers that Require Contributions from Property Owners

As stated earlier, funding for mitigating repetitive loss structures currently comes from the Hazard Mitigation Grant Program (HMGP), the Flood Mitigation Assistance Program (MAP) and the Pre-Disaster Mitigation program (PDM). Both the HMGP and the PDM provide that 25 percent of the cost of the mitigation must come from non-federal contributions. In theory, these non-federal

contributions should come from the states or local governments. It is our understanding, however, that in some cases, states and local governments are unable to fund the non-federal contribution, placing this obligation on the homeowner. To take advantage of individual buyout offers, homeowners are required to provide the 25 percent contribution. The contribution can be funded with proceeds from flood insurance claims and other assistance. Unfortunately, this total compensation is not always sufficient to cover the remaining 25 percent. Borrowers, in many cases, will be reluctant to lose the equity invested in their home or may not have the funds to contribute to the mitigation effort. MBA believes that the penalties described in the bills would not be appropriate in these cases. Also, some consideration might be given to increasing the amount of federal contribution.

Appeals

MBA supports the appeals process found in H.R. 670. H.R. 670 allows homeowners to appeal a decision to cancel flood insurance or increase the insurance rates. This process appears to mirror FEMA's current appeals process, which allows homeowners to present evidence to disprove the repetitive loss property classification. We applaud such an appeals concept. However, to the extent that property owners will be subject to penalties for rejecting a mitigation offer, we believe aggrieved property owners should also be able to contest these penalties by providing evidence that a mitigation offer would violate one of the exemptions in the bill or otherwise result in significant hardship for the homeowner. Such a concept recognizes that situations vary. Individual homeowners may have circumstances that warrant a waiver of the penalty on a case-by-case basis. Real life circumstances may truly justify rejecting assistance.

Knowledge of Repetitive Loss

H.R. 253 would impose actuarial rates and deny disaster relief assistance on properties that have had two or more flood insurance claim payments of $1,000 each within a 10-year period, *regardless of ownership of the property,* and where the property owner has rejected a mitigation offer. It is unclear how a prospective homebuyer or mortgagee would be notified of the property's flood history or mitigation offers so that he or she can determine whether to accept the risk. Disclosures by current property owners would be deficient because they could only cover events that occurred during the person's ownership. Flood claims made two or three owners prior would be difficult to uncover unless the events were publicly accessible through a FEMA-provided database.

MBA thanks the Subcommittee for this opportunity to submit testimony. We appreciate your outreach to the real estate finance industry and your willingness to consider our concerns. We understand the good intentions behind this legislation and we believe that the bills, with some modifications, will go a long

way to improve and expand FEMA's loss mitigation efforts. We hope the Subcommittee will agree, however, some additional enhancements would be worthwhile to balance the interest of the federal government in curbing repetitive losses, the lender's need to protect its customers and collateral, and the property owner's emotional and financial interest in his or her property. We would be happy to furnish any additional information that the Subcommittee might request.

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Statement for
National Association of Professional Insurance Agents
For the U.S. House Financial Services Committee
Subcommittee on Housing and Community Opportunity
April 1, 2003

The following testimony reflects PIA National's internal expertise developed over the years of its regular participation in the National Flood Insurance Program process and the collective experiences of PIA members who write flood insurance through NFIP. PIA is also a founding member of the Flood Insurance Producers National Committee. FIPNC was organized by FEMA/FIMA for the purpose of providing expert guidance from insurance agents that each day writes federal flood insurance business, as a regular part of their larger property and casualty insurance agency business.

Profile of the PIA Member Agency:
PIA National members are the owner/principals of their independent insurance agencies. They employ an average of seven to nine full-time individuals including themselves, who are licensed as insurance producers. Additionally, they employ two to four individuals who are not licensed producers. PIA members represent an average of between five and seven property and casualty carriers and two to three life and health carriers.

PIA & The National Flood Insurance Program:
Background
In the 1960's PIA (then known as The National Association of Mutual Insurance Agents) believed that with the proper underwriting, countrywide rate zoning and special treatments for reserves for catastrophic losses, flood and earthquake insurance could be provided to property owners. PIA led successful efforts to create a federal insurance program providing needed flood coverage for homes and businesses. It was PIA members in D.C., Virginia and Maryland that wrote the first 100 policies sold under the National Flood Insurance Program.

Two Fundamental Areas:
PIA National believes that the timing of NFIP authorization as well as Congressional and NFIP funding are two fundamental areas needing to be addressed.

1. **Authorization**– PIA National firmly believes that NFIP must have multi-year authorization by Congress in order to operate a continuance, balanced, orderly program.

   A five-year authorization is attainable and desirable for the program's sake and fully responsive to Congress' evaluation obligations.

   PIA understands given the current discussions and review of NFIP, a five-year timetable may not be possible. However, we ask for no less than a two-year reauthorization timetable implemented when the December 31, 2003 current NFIP authority is set to expire. This would bring us to December 31, 2005, timing this to the mid-term of a Congressional cycle, the timing we request for NFIP reauthorization date.

   This position is unanimously adopted by all member-organizations of FIPNC.

   2.Congressional and NFIP Monies - Monies ear-marked for NFIP by Congress should be exclusively retained for NFIP's direct expenses and maintenance. Monies needed to support the administrative organization costs of the NFIP should be secured and used for those purposes and no others.
   Further, Congress must be prudent, but realistic as to the costs of both running and supporting the NFIP.

   NFIP reserve and income earned premium monies should not be used for purposes other than direct NFIP flood loss events.

   Monies to support FEMA/FIMA and their agency role in the Department of Homeland Security should not come from NFIP monies secured, authorized or collected for purposes to direct NFIP programs, especially when they are monies from the reserve accounts.

   For example: Administrative costs for the Department of Homeland Security should be secured from within already identified FEMA/FIMA agency administrative costs and not from NFIP monies already ear-marked for NFIP mapping programs or other like programmatic expenses. Further, monies for FIMA in these areas should not be used to serve the expanded purposes and programs that DHS may assign to FEMA/FIMA.

   Also, when created, NFIP was designed to operate more than not as a traditional insurance program would, collecting and reserving monies for flood events. As such it is a given that some years will result in the cost of flood claims exceeding the premium collected that year, and perhaps the reserves at hand. However,

there will be other years where flood losses will be low, giving the premium reserve and interest income account time to grow.

Current deficient in NFIP premium reserves-to-covered flood events payouts would be far less dramatic had NFIP former reserves not been tapped (during a prior Administration) to offset basic agency-program operating costs. At that time Congress viewed NFIP premium account monies as "over-reserved". Congress significantly decreased FIMA's ongoing regular administrative costs. The unambiguous inference/suggestion to FIMA was that the NFIP "over-reserved" premiums could be diverted as the source for agency administrative funds shortfall.

PIA supports that FEMA/FIMA have many experiences/expertise that will serve well the broadened agenda of DHS. Therefore, we support the expanded role of FEMA/FIMA, but not so that it interferes or lessens the attention and support of NFIP, especially in terms of NFIP specific and needed monies.

All members and their respective organizations of FIPNC also support these positions.

Necessary Improvements to the National Flood Insurance Program

NFIP-States-Municipal Governments:
State and municipal governments must:

1. Work with NFIP (FEMA/FIMA) to more thoroughly assure their understanding of and support for the technical needs of NFIP risk management.

2. Work with the federal government to update mutual property/zone mapping responsibilities and results. State and local governments have just as much invested in the accuracy and access to such maps – traditional to the duty and control of local authorities.

3. Work with survey employees, independent firms and independent contractors to be up to date on what the elements on the elevation certificate mean, how they need to be secured, why their professional signed opinion is necessary, and determine causes of the extraordinary spike in elevation certificate expenses being passed on to consumers.

4. In addition, PIA believes that the flood requirements of the NFIP Elevation Certificate should become a normal and regular part of the official property recordings for plot/pre-building/final site public filing. With this, communities should also forged an increased working/action partnership with flood plain mangers to more completely follow their guidance on building issues v/v flood. These would combine to make moot the current NFIP elevation certificate as a unique and separate process. Instead, communities

would be imposing flood compliance in their regular property activities from the first step, requiring all land use and projects to meet or exceed BFE. These were the original goals of the NFIP process.

5. Identify the infrastructure improvements required in their state for flood prevention structures such as – levy, dikes, canals, over-spills and others and work with federal agencies to secure joint-funding,

6. Work on evolved, improved flood plain management emerging issues such as the alarming increase in the number of LOMRs, LOMAs and such that are being approved. An increasing number of these may pass local "landfill" requirements. However, many of those requirements were set for sanitation/pollution/contamination concerns and not with sufficient address to flood-worthiness standards. Additionally, some of these exceptions are secured based upon vacant land use that does not conceive the future use to which the land may be placed.

7. Work out a more successful approach to the use, protection and flood-recovery for certain lands/properties that pre-date and/or are by other means grand-fathered by the NFIP program and its terms.

   PIA appreciates that such locations are believed to have significant value or meaning to the history, economy or homestead needs of an area and its populations. However, the e number of lands and properties in these classes must remain limited by their very nature. Their treatment under NFIP/federal disaster needs must be addressed from the perspective of a government benefit program.

   PIA asks that Congress no longer place FEMA/FIMA, NFIP and/or the insurance participants in a "no-win" position.

   Currently, the difficulties are that on the one hand, Congress expects NFIP to treat such exceptions as "regular insuring prospects" to be underwritten, rated and serviced as all other properties under NFIP. PIA does not believe that they can ever be treated and many times should not as such. On the other hand, Congress responds with confusion and anger when such properties are identified and treated as the significant flood-exposed uninsurable properties they are under the traditional application of NFIP standards. This is at the same time that Congress laments the number of repetitive flood-loss payouts.

Insurance Sector and FEMA/FIMA:

1. Continue to resolve needed improvements in the areas of policy form language, underwriting procedures, rating and claims services.

2. Increase coordination and compatibility between/among NFIP, insurance and lender evaluations of properties.

3. Continue to work on finding solutions to a growing number of conflicts between federal legal views and framework of NFIP verses related specific areas under state law.

4. Respond to the reasonable level of carrier reimbursement for the usual and required expenses of the NFIP. These levels should, as they are, be subject to pre-set standards and periodic review and when needed adjustment. However, limiting or decreasing these reimbursements as federal cost-saving mechanisms cannot be allowed.

Insurance Agents and Carriers:
PIA encourages its members to actively write flood insurance coverage for their clients or know through their carriers or association programs quality agencies that write this business and to which they can refer their clients.

1. In doing so agents should exercise their internal Errors &Omissions procedures to document the discussions about flood insurance, the fact that coverage was offered/a referral was made, and with the consumer/client document the client's acceptance or decline of this offer.

2. Carriers and agents should write a lot of this business or know a qualified local agent that does to direct their customers to.

3. PIA supports Departments of Insurance granting continuing education credits (CE) for both in-classroom, long-distance, and qualified self-study courses for flood insurance.

4. Carriers and vendors that write NFIP business through and with insurance producers must take (as many do but not all) an active role in providing quality underwriting, rating, processing and claims service, as well as coverage/practice education to their producers on flood insurance.

5. These education programs must be directed by qualified instructors that understand both the NFIP program AND the traditional private sector insurance property coverage and law environment in which flood insurance coverage, producers, carriers, lenders, determination companies, surveyors, flood plan managers and others find themselves.

Closing:
PIA hopes that by working together with the many private sector, public interest, local, state and federal government agencies and Congress, our suggestions for NFIP's improvements will continue to support and improve this vital, needed federal program.

Certainly the outline developed for the internal review/study of NFIP provides all of us with a starting point for these ongoing discussions. Our comment here connects PIA's

knowledge to the related areas in the suggested NFIP study outline that Congress has requested.

PIA looks forward to expanding our continuing working efforts with NFIP parties at interest to Congress and the vendors for the NFIP study.

NATIONAL ASSOCIATION OF REALTORS®

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STATEMENT OF

THE NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED TO
THE HOUSE FINANCIAL SERVICES COMMITTEE
HOUSING AND COMMUNITY OPPORTUNITY
SUBCOMMITTEE

ON

THE NATIONAL FLOOD INSURANCE PROGRAM

APRIL 1, 2003

Thank you for the opportunity to submit a statement presenting the views of the NATIONAL ASSOCIATION OF REALTORS® (NAR) on the National Flood Insurance Program (NFIP) and related repetitive flood loss legislation.

The more than 880,000 members of NAR wish to thank Chairman Ney for holding this hearing on a subject that is of great importance to REALTORS®. We also wish to recognize Representatives Doug

Bereuter, Richard Baker and Earl Blumenauer for their ongoing efforts to improve the NFIP.

It is often said that REALTORS® don't sell homes, we sell communities. The members of the NATIONAL ASSOCIATION OF REALTORS® are concerned and active members of our communities. We recognize and support the important role that the National Flood Insurance Program plays in managing the risk of flooding which affects so many of our communities.

The NFIP is a unique partnership between our three levels of government. It enables property owners in participating communities to purchase insurance as a protection against flood losses in exchange for State and community floodplain management regulations that reduce future flood damages. As a result, federal expenditures for disaster assistance and flood control are reduced.

The National Flood Insurance Program partners with over 19,000 communities nationwide and holds 4.4 million policies representing $623 billion in insurance coverage. It provides over 90% of all flood insurance nationwide and close to 100% of flood insurance coverage for individually-owned properties and small- to mid-size commercial properties. Ninety-one insurance companies write flood insurance,

either under the Write Your Own program or through direct sales. In FY 2002, the program generated $1.4 billion in written premiums, with an average premium of $393, average coverage of $142,204, and an average pay out of $24,551. By providing affordable flood insurance that is unavailable in the private market, the NFIP helps our citizens achieve the American dream of homeownership.

There are three issues concerning the National Flood Insurance Program that are important to the real estate industry. First, the costly impact of repetitive loss properties. Second, the importance of accurate and dependable floodplain maps. Third, Congressional reauthorization of the program.

Currently, 45,000 insured properties nationwide have incurred two or more flood losses over a ten-year period. These properties cost the flood insurance program over $200 million annually. The top 10,000 structures alone cost the program over $65 million annually.

Repetitive loss properties inflict serious economic harm to the flood insurance program by driving up the premiums for all other policyholders, and by allowing the entire system to rest upon an unsustainable actuarial foundation. These properties are not paying premiums that adequately reflect their exposure to the risk of flooding.

NAR believes that Congress must address the repetitive loss issue in order to place the flood insurance program on firmer financial ground. We support an approach that has three main components: (1) repetitive loss properties remain eligible for federal flood insurance; (2) flood mitigation measures or buy-outs at fair market value are offered to the worst repetitive loss properties; and (3) if a mitigation or buy-out offer is refused, the owner of a repetitive loss property will be required to pay the highest allowable insurance premium. This win-win approach ensures that insurance payouts will be reduced by properly mitigating or buying out the worst repetitive loss properties. At the same time, it allows the property owner to remain in the program, while paying a premium that adequately reflects the property's flood risk.

There are several additional issues that we feel should be given consideration in repetitive loss legislation. First, we urge that properties acquired through buy-outs are put to appropriate uses and are well-maintained so that they do not decrease the value of adjacent properties. Second, we encourage the use of local appraisers in determining fair market value for property buy-outs. Local appraisal professionals have in-depth knowledge of local real estate markets and are well-equipped to render fair market value determinations.

Finally, it is critical that flood insurance remain accessible and equitable for all individuals who own property in a floodplain. NAR opposes a phase-out of subsidized flood insurance for second homes and rental properties. Non-primary residences should be given the same consideration as primary residences. These properties face a flooding risk which is identical to that of adjacent primary residences. For reasons of fundamental fairness, they should not be charged full risk premiums unless they fall under the definition of repetitive loss properties. Furthermore, charging full risk premiums for second homes and rental properties would significantly increase their insurance costs. Consequently, the purchase price of homes in resort and coastal areas would increase, their affordability and marketability would decrease, and local economies would suffer. Owners of rental properties would be forced to pass on the increased costs of flood insurance through rent increases to their tenants, placing additional strain on the budgets of low- and fixed-income renters.

Our second area of concern is FEMA's Flood Insurance Rate Maps. Flood maps determine whether a property is located in a floodplain, and thus whether flood insurance is required in order to secure a mortgage. When maps are inaccurate, properties incorrectly included in a floodplain are unnecessarily required to have flood insurance coverage. Similarly, properties incorrectly excluded from a

floodplain are exposed to flood risk without the benefit of insurance coverage. During a property transaction, correction of an inadvertent inclusion - through FEMA's Letter of Map Amendment process - adds unnecessary cost and delay to the transaction.

Flood maps serve a number of other important functions. The National Oceanographic and Atmospheric Administration estimates that the cost of flood damage in the 1990s exceeded $5 billion annually, with an average of 100 deaths per year due to flooding. To limit the costly impact of floods, flood maps help communities develop flood management strategies, implement more effective land use and building codes, develop disaster preparedness plans, and incorporate disaster planning into regional economic development strategies.

FEMA plans to modernize its floodplain maps by replacing the existing paper maps with computerized maps that are more accurate, more accessible, and easier to keep current. FEMA's map modernization program goes beyond simple replacement of paper maps with digital ones. Digital technology will allow FEMA to collect new and better data.

NAR was pleased that Congress recognized the importance of accurate and dependable floodplain maps and provided FEMA with an

additional $150 million in FY 2003 to begin its map modernization program. That is just the beginning, however, and additional funds are needed. For FY 2004, FEMA has requested $200 million to continue its map modernization program. We strongly encourage Congress to appropriate the full amount so that FEMA can complete this important project.

Last, but not least, is the issue of NFIP reauthorization. In November 2002, the 107th Congress adjourned without extending FEMA's statutory authority to issue flood insurance policies beyond December 31, 2002. Thankfully, Congress and the President acted quickly in the early days of this Congress to pass and sign retroactive reauthorization. In the interim, FEMA and a coalition of public and private sector organizations worked hard to provide guidance to private industry and the public and prevent disruptions in the real estate, insurance and lending industries.

Although disruptions were largely averted, such a lapse of authority could have severe repercussions for an industry that was one of the few bright spots in the 2002 economy. Last year set a record for existing home sales, and the housing market is projected to remain strong in 2003. An absence of authorization raises compliance and legal questions for lenders and insurers. In such an uncertain climate, home

purchases and insurance policy renewals are jeopardized. For prospective home buyers, this can mean an opportunity delayed or – at worst - lost entirely. FEMA estimates that a short lapse in authority could affect approximately 400,000 households seeking to obtain or maintain flood insurance.

This situation should not be allowed to re-occur. NAR encourages Congress to reauthorize the NFIP in a timely manner each year. As an alternative, we encourage Congress to consider a multi-year reauthorization in order to provide program continuity and prevent a re-occurrence of last year's situation.

Thank you for allowing the NATIONAL ASSOCIATION OF REALTORS® an opportunity to share our views on the National Flood Insurance Program. We urge the Subcommittee to undertake a bi-partisan effort and pursue improvements that will strengthen the program and make it even more effective. We look forward to working with you in support of this effort.

April 1, 2003

Re: Support for H.R. 253, "Two Floods and You Are Out of the Taxpayers Pocket Act"

Dear Representatives Bereuter and Blumenauer,

Taxpayers for Common Sense Action applauds you for introducing H.R. 253, the "Two Floods and You Are Out of the Taxpayers' Pocket Act." This bill will help repetitive loss property owners out – out of the floodplain. It will also help ease the burden of repetitive loss claims on the National Flood Insurance Program and on taxpayers.

This bill requires that any property that claims damages more than $1000 at least twice in a 10-year period must flood-proof, elevate or move their homes with the help of government assistance. If property owners do not take these actions then their flood insurance will cease to be subsidized by the government and they will be forced to bear the full actuarial, risk-based cost of the insurance for that property.

Repetitive loss properties threaten the stability of the NFIP; while only making up 1% of the properties covered by NFIP, they represent 25% of damages collected in an average loss year. In recent years, the NFIP had to borrow $720 million from the Treasury Department in order to meet the needs of its claims. The "Two Floods and You are Out of the Taxpayers Pocket" legislation could reduce the federal burden by up to $200 million a year, by removing repetitive loss properties or at least making their insurance payments proportionate to the risk.

This bill takes a great step forward to make the National Flood Insurance Program more sustainable and to ease the burden on taxpayers. It would reduce the burden on the federal government to pay for avoidable flood damages on the same properties year after year, along with helping flood insurance policy holders out of the floodplain. Taxpayers for Common Sense Action strongly supports this legislation and appreciates your leadership in introducing H.R. 253, the "Two Floods and You Are Out of the Taxpayers Pocket Act."

Sincerely,

Steve Ellis
Vice President of Programs

An independent watchdog for the taxpayers of today and tomorrow
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United States General Accounting Office

GAO

Testimony

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

Not to be Released before
2:00 p.m. EST
Tuesday, April 1, 2003

FLOOD INSURANCE

Challenges Facing the National Flood Insurance Program

Statement for the Record by
JayEtta Z. Hecker, Director,
Physical Infrastructure

GAO-03-606T

GAO
Accountability·Integrity·Reliability
Highlights

Highlights of GAO-03-606T, testimony for the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

April 1, 2003

FLOOD INSURANCE

Challenges Facing the National Flood Insurance Program

Why GAO Did This Study

Floods have been, and continue to be, the most destructive natural hazard in terms of economic loss to the nation. The National Flood Insurance Program is a key component of the federal government's efforts to minimize the damage and financial impact of floods. The program identifies flood-prone areas of the country, makes flood insurance available in the nearly 20,000 communities that participate in the program, and encourages flood-plain management efforts. Since its inception in 1969, the National Flood Insurance has provided $12 billion in insurance claims to owners of flood-damaged properties, and its building standards are estimated to save $1 billion annually. The program has been managed by the Federal Emergency Management Agency, but along with other activities of the agency, it was recently placed into the Department of Homeland Security.

GAO has issued a number of reports on the flood insurance program and was asked to discuss the current challenges to the widespread success of the program.

www.gao.gov/cgi-bin/getrpt?GAO-03-606T.

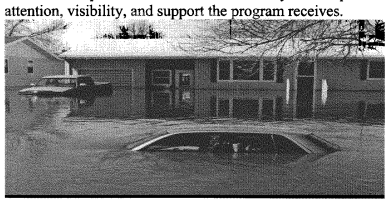
To view the full testimony, click on the link above.
For more information, contact JayEtta Z. Hecker, (202) 512-2834, Heckerj@gao.gov.

What GAO Found

The program faces the following challenges in operating the program effectively and protecting property owners from loss from floods.

- **Improving information on the program's financial condition.** Cash-based budgeting, which focuses on the amount of funds that go in and out of a program in a fiscal year, obscures the program's costs and does not provide information necessary to signal emerging problems, such as shortfalls in funds to cover the program's risk exposure. Accrual-based budgeting better matches revenues and expenses, recognizes the risk assumed by the government, and has the potential to overcome the deficiencies of cash-based budgeting.
- **Reducing losses to the program resulting from policy subsidies and repetitive loss properties.** The program has lost money and is not actuarially sound because about 29 percent of the policies in force are subsidized but appropriations are not provided to cover the subsidies. Owners of structures built before the flood zone was included in the program pay reduced premiums that represent only about 35-40 percent of the true risk premium. Further, repetitive loss properties—properties with two or more losses in a 10-year period—add to program losses as they represent 38 percent of claims losses but account for 2 percent of insured properties.
- **Increasing property owner participation in the program.** The administration has estimated that less than 50 percent of eligible properties in flood plains participate in the program. Additionally, even when the purchase of insurance is mandatory, the extent of noncompliance with the mandatory purchase requirement is unknown and remains a concern.

Actions have been initiated or proposed by the administration or in the Congress to address some of the challenges. However, the affect of some actions on the program is not clear. For example, reducing subsidies may cause some policyholders to cancel their policies, reducing program participation and leaving them vulnerable to financial loss from floods. Further, placement of the program within the Department of Homeland Security has the potential to decrease the attention, visibility, and support the program receives.



Source: FEMA Photo Library

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to submit this statement for the record on the National Flood Insurance Program and challenges to its success. Floods have been, and continue to be, the most destructive natural hazard in terms of economic loss to the nation. The flood insurance program, which has been administered by the Federal Emergency Management Agency (FEMA), has been a key component of the federal government's efforts to minimize the impact of floods and to provide flood-related disaster relief. For example, the program has been credited by the administration with saving a billion dollars annually by improving flood plain management and setting building standards—such as one to elevate properties—that have reduced potential losses. Additionally, the approximately $12 billion paid in insurance claims from 1969 through 2002 to policyholders has been funded primarily by policyholders' premiums, thus saving the federal government from paying all damage-related expenses in the aftermath of floods.

Nevertheless, the flood insurance program faces challenges. In reports published within the last few years, FEMA's Inspector General and we have identified a number of concerns with the program's financial viability and with the extent to which flood insurance policies have been purchased for structures in flood-prone areas. In addition, the administration noted in its fiscal year 2004 budget request that the program is only moderately effective; it and the Congress have proposed measures to improve the program's effectiveness. With the creation of the Department of Homeland Security (DHS) and the inclusion of FEMA's functions within it, the program—along with its associated problems and improvement measures—has now become the responsibility of the new department.

My statement today is based primarily on our past work and on preliminary results from ongoing work that we are conducting for the Subcommittee examining flood zone remapping efforts. I will provide a perspective on (1) the program's presentation of financial information, (2) the major causes of losses in the program, (3) the extent of property owner participation in the program, and (4) recent actions taken or proposed to improve the program. In summary:

- The flood insurance program's use of cash-based budgeting may present misleading information on the program's financial condition. Cash-based budgeting, which focuses on the amount of funds into and out of the program in a fiscal year, can obscure the program's costs because the time between the extension of insurance, the receipt of premiums, the occurrence of insured events, and payment of claims may extend over several fiscal years. Further, this form of budgeting may not provide the information necessary to signal emerging problems, such as shortfalls in funds to cover the program's risk exposure. The use of accrual-based budgeting—which, among other things, better matches revenues and expenses and recognizes the liability for future insurance claim payments—has the potential to overcome a number of the deficiencies in cash-based budgeting.
- Subsidies on certain policies and so-called repetitive loss properties—properties that have experienced two or more losses greater than $1,000 in a 10-year period—have been the principal causes of the flood insurance program's long-term losses. About 29 percent of all policies in force are subsidized, and on average the premiums for these policies are only about 35-40 percent of—and about $500 million annually less than—the true risk premium for those properties. Additionally, about 38 percent of all program claims have been the result of repetitive loss properties, at a cost of about $200 million annually.
- Flood insurance program participation—the percentage of structures in designated flood zones that are insured—may be low, resulting in many property owners being at risk of financial loss due to flooding. The administration estimates that less than half of the eligible properties in flood plains participate in the program. Further, even when the purchase of flood insurance is mandatory—properties in flood zones with mortgages from federally regulated lenders are required to have flood insurance—the extent of noncompliance with this requirement is unknown and remains a concern.
- Recent actions have been taken or proposed by the administration and the Congress that may affect the program. These include actions to eliminate the premium subsidy on properties that are second homes or vacation properties, to phase out coverage or begin charging full and actuarially based rates for repetitive loss properties, and to undertake an

expanded program to update flood maps upon which the program bases its insurance rates and mandatory purchase requirements. While these actions will address some of the challenges in the program, certain actions may have adverse implications—for example, increasing premiums to subsidized policyholders may cause some to cancel their insurance and remapping flood zones may bring into the program more properties that could be subsidized. Moreover, action has not been taken to move the program to accrual-based budgeting. Finally, the placement of the program--which is not directly security related—into the new Department of Homeland Security may affect the amount of attention the program receives as it pursues nonsecurity- related goals in a department that is under tremendous pressure to succeed in its primary mission of securing the homeland.

Before I discuss these issues in greater detail, I would like to briefly explain the National Flood Insurance Program and its importance to the federal flood management effort.

The National Flood Insurance Program Has Sought to Minimize Flood-Related Losses

In 1968, in recognition of the increasing amount of flood damage, the lack of readily available insurance for property owners, and the cost to the taxpayer for flood-related disaster relief, the Congress enacted the National Flood Insurance Act (P.L. 90-448) that created the National Flood Insurance Program. Since its inception, the program has sought to minimize flood-related property losses by making flood insurance available on reasonable terms and encouraging its purchase by people who need flood insurance protection—particularly those living in flood-prone areas known as special flood hazard areas. The program identifies flood-prone areas in the country, makes flood insurance available to property owners in communities that participate in the program,[1] and encourages floodplain management efforts to mitigate flood hazards. The program has paid about $12 billion in insurance claims, primarily from policyholder premiums that otherwise would, to some extent, have increased taxpayer-funded disaster relief.

[1]Nearly 20,000 communities across the United States currently participate in the program, including Puerto Rico and the Virgin Islands.

Under the program, flood insurance rate maps (FIRM) have been prepared to identify special flood hazard areas—also known as 100-year floodplains—that have a 1-percent or greater chance of experiencing flooding in any given year. For a community to participate in the program, any structures built within a special flood hazard area after the FIRM was completed must be built according to the program's building standards that are aimed at minimizing flood losses. A key component of the program's building standards that must be followed by participating communities is a requirement that the lowest floor of the structure be elevated to or above the base flood level—the highest elevation at which there is a 1-percent chance of flooding in a given year. The administration has estimated that the program's standards for new construction are saving about $1 billion annually in flood damage avoided.

When the program was created, the purchase of flood insurance was voluntary. To increase the impact of the program, however, the Congress amended the original law in 1973 and again in 1994 to require the purchase of flood insurance in certain circumstances. Flood insurance was required for structures in special flood hazard areas of communities participating in the program if (1) any federal loans or grants were used to acquire or build the structures or (2) the structures are secured by mortgage loans made by lending institutions that are regulated by the federal government. Owners of properties with no mortgages or properties with mortgages held by unregulated lenders were not, and still are not, required to purchase flood insurance, even if the properties are in special flood hazard areas.

The National Flood Insurance Reform Act of 1994 that amended the program also reinforced the objective of using insurance as the preferred mechanism for disaster assistance. The act expanded the role of federal agency lenders and regulators in enforcing the mandatory flood insurance purchase requirements. It prohibited further flood disaster assistance for any property where flood insurance was not maintained even though it was mandated as a condition for receiving prior disaster assistance. Regarding the prohibition on further flood disaster assistance, the act prohibits borrowers who have received certain disaster assistance, and then failed to obtain flood insurance coverage, from receiving future disaster aid.

FEMA's Federal Insurance and Mitigation Administration has been responsible for managing the flood insurance program. However, the Homeland Security Act of 2002[2] transferred this responsibility to the Department of Homeland Security (DHS). As part of the largest reorganization of the federal government in over 50 years, the legislation combined about 170,000 federal employees, 22 agencies, and various missions—some that have not traditionally been considered security related—into the new department. FEMA's responsibilities, including the flood insurance program, were placed in their entirety into DHS, effective March 1, 2003. Responsibility for the flood insurance program now resides in DHS's Emergency Preparedness and Response Directorate.

Cash-basis Budgeting Does Not Provide All Needed Information on Flood Insurance Program's Financial Condition

Historically, federal government programs, including the National Flood Insurance Program, report income and expenditures on a cash basis—income is recorded when received and expenditures are recorded when paid. Over the years, the annual reporting of the program's premium revenues and its claims losses and expenses has shown wide fluctuations in cash-based operating net income or losses. For example, for fiscal year 2002, the program had a net income of $755 million, but in the previous year it had a net loss of $518 million. For the life of the program, the program has shown a net loss of $531 million. The program has, on numerous occasions, borrowed from the U.S. Treasury to fund claims losses.

This "cash-based" budgeting, although useful for many government programs, may present misleading financial information on the flood insurance program. In 1997 and again in 1998,[3] we reported that cash-based budgeting has shortcomings for federal insurance programs. Specifically, its focus on single period cash flows can obscure the program's cost to the government and thus may (1) distort the information presented to policymakers, (2) skew the recognition of the program's economic impact, and (3) cause fluctuations in the deficit unrelated to long-term fiscal balance. The focus on annual cash flows—the amounts of funds into and out

[2]P.L. 107-296, Nov. 25, 2002.
[3]U.S. General Accounting Office, *Budget Issues: Budgeting for Federal Insurance Programs*, GAO/AIMD-97-16 (Washington, D.C.: Sept. 30, 1997) and *Budget Issues: Budgeting for Federal Insurance Programs*, GAO/T-AIMD-98-147, (Washington, D.C.: Apr. 23, 1998).

of a program during a fiscal year—may not reflect the government's cost because the time between the extension of the insurance, the receipt of premiums, the occurrence of an insured event, and the payment of claims may extend over several fiscal years.

For the flood insurance program, cash-based budgeting may not provide the information necessary to signal emerging problems, make adequate cost comparisons, or control costs. For example, under its current practices, the program provides subsidized policies without explicitly recognizing the potential cost to the government. Under current policy, the Congress has authorized subsidies to be provided to a significant portion of the total policies in force, without providing annual appropriations to cover the potential cost of these subsidies. The program, as designed, does not charge a premium sufficient to cover its multiyear risk exposure. As a result, not only is the program actuarially unsound, but also the size of the shortfall is unknown. This is a concern that the administration has recognized and identified as a financial challenge to the flood insurance program.

The use of accrual-based budgeting for the flood insurance program has the potential to overcome a number of the deficiencies in cash-based budgeting. Accrual-based budgeting (1) recognizes transactions or events when they occur, regardless of cash flows; (2) matches revenues and expenses whenever it is reasonable and practicable to do so; (3) recognizes the cost for future insurance claim payments when the insurance is extended; and (4) provides a mechanism for establishing reserves to pay those costs. In short, because of the time lag between the extension of an insurance commitment, the collection of premiums, and the payment of claims, measuring the financial condition of the flood insurance program by comparing annual premium income and losses creates a budgetary distortion. That distortion, together with the misinformation it conveys, could be reduced or eliminated by accrual-based budgeting.

In our 1997 report, we pointed out that developing accrual-based budgets would be challenging, requiring the development of models to generate reasonably reliable cost estimates of the risks assumed by federal insurance programs. Nevertheless, the potential benefits to the flood insurance program, as well as other federal insurance programs, warrant the effort to develop these risk-assumed cost estimates. We suggested that the Congress consider encouraging the

development and subsequent reporting of annual risk-assumed cost estimates for all federal insurance programs. At this time, the flood insurance program is still using cash-based budgeting for reporting its financial performance. We continue to believe that the development of accrual-based budgets for the flood insurance program would be a valuable step in developing a more comprehensive approach for reporting on the operations and real costs of this program.

Policy Subsidies and Payments for Repetitive Losses Contribute to Program Losses

The National Flood Insurance Program has raised financial concerns because, over the years, it has lost money and at times has had to borrow funds from the U.S. Treasury.[4] Two reasons—policy subsidies and payments for repetitive losses—have been consistently identified in our past work and by FEMA to explain financial challenges in the National Flood Insurance Program. First, the flood insurance program has sustained losses, and is not actuarially sound, largely because many policies in the program are subsidized. The Congress authorized the program to make subsidized flood insurance rates available to owners of structures built before a community's FIRM was prepared.[5] For a single-family pre-FIRM property, subsidized rates are available for the first $35,000 of coverage, although any insurance coverage above that amount must be purchased at actuarial rates. These pre-FIRM structures are generally more likely to sustain flood damage than later structures because they were not built according to the program's building standards. The average annual premium for a subsidized policy is $637, representing about 35-40 percent of the true risk premium for these properties.

According to flood insurance program officials, about 29 percent of the 4.4 million policies in force are currently subsidized. Although this percentage of subsidized policies is substantially lower than it was in the past, it still results in a significant reduction in revenues to the program. Program officials estimate that the total premium income from subsidized policyholders is currently about $500 million per year less than it would be if these rates had been actuarially based and participation remained the same. Originally, funds to support subsidized premiums were appropriated for the flood insurance program; however, since the mid-1980s no funds have

[4]At this time, all funds borrowed from the U.S. Treasury have been repaid.
[5]Owners of post-FIRM structures pay actuarial rates for flood insurance.

been appropriated, and the losses resulting from subsidized policies must be borne by the program.

As we reported in July 2001,[6] increasing the premiums charged to subsidized policyholders to improve the program's financial health could have an adverse impact. Elimination of the subsidy on pre-FIRM structures would cause rates on these properties to rise, on average, to more than twice the current premium rates. Program officials estimate that elimination of the subsidy would result in an annual average premium of about $1,300 for pre-FIRM structures. This would likely cause some pre-FIRM property owners to cancel their flood insurance.[7] Cancellation of policies on these structures—which are more likely to suffer flood loss—would in turn increase the likelihood of the federal government having to pay increased costs for flood-related disaster assistance to these properties. The effect on the total federal disaster assistance costs of phasing out subsidized rates would depend on the number of policyholders who would cancel their policies and the extent to which future flood disasters affecting those properties occurred. Thus, it is difficult to estimate whether the increased costs of federal disaster relief programs would be less than, or more than, the cost of the program's current subsidy.

In addition to revenue lost because of subsidized policies, significant costs to the program result from repetitive loss properties. According to FEMA, about 38 percent of all claims historically, and about $200 million annually, represent repetitive losses—properties having two or more losses greater than $1,000 within a 10-year period. About 45,000 buildings currently insured under the program have been flooded on more than one occasion and have received flood insurance claims payments of $1,000 or more for each loss. Over the years, the total cost of these multiple-loss properties to the program has been about $3.8 billion.

Although repetitive loss properties represent about one-third of the historical claims, these properties make up a small percentage of all program policies. A 1998 study by the National Wildlife Federation noted that repetitive loss properties represented only 2 percent of all

[6]U.S. General Accounting Office, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, GAO-01-992T (Washington, D.C.: July 19, 2001).
[7]Owners of pre-FIRM properties required to maintain flood insurance (i.e. properties with mortgages made or held by federally regulated lending institutions) would not be able to cancel their policies.

properties insured by the program, but they tended to have damage claims that exceeded the value of the insured structure and most were concentrated in special flood hazard areas. For example, nearly 1 out of every 10 repetitive loss homes has had cumulative flood loss claims that exceeded the value of the house. Furthermore, over half of all nationwide repetitive loss property insurance payments had been made in Louisiana and Texas. About 15 states accounted for 90 percent of the total payments made for repetitive loss properties.

Participation in the Program May Be Low

Not only does the National Flood Insurance Program face challenges with its financial condition, but also in achieving one of the purposes for which it was created—to make flood insurance the mechanism for property owners to cover flood losses. Participation rates—the percentage of structures in special flood hazard areas that are insured—provide a measure to indicate the degree to which the owners of properties vulnerable to flooding are protected from financial loss through insurance, the financial risk to the government from flood-related disaster assistance is decreasing, and the program is obtaining high levels of premium income. The rate of participation in the program, however, may be low. In its fiscal year 2004 budget request, the administration noted that less than half of the eligible properties in flood areas participate in the program, a participation rate that was significantly lower than the nearly 90 percent participation rate for wind and hurricane insurance in at-risk areas.

No comprehensive data are available to measure nationwide participation rates. However, various studies have identified instances where low levels of participation existed. For example:

- A 1999 DeKalb County, Georgia, participation study determined that of over 17,000 structures in the special flood hazard areas, about 3,100—18 percent—had flood insurance.
- A 1999 FEMA post-disaster study of 11 counties in Vermont found that 16 percent of homes sampled in the special flood hazard areas had flood insurance.
- A 1999 study by the Strategic Advocacy Group of two counties in Kentucky that had experienced flood disasters found that flood insurance was in force for 52 percent of

homes mortgaged since 1994 and was in force for 30 percent of homes mortgaged before 1994.

- An August 2000 FEMA Inspector General study that noted that statistics from North Carolina showed that of about 150,000 structures in special flood hazard areas, 33 percent were covered by flood insurance.

FEMA estimates that one-half to two-thirds of those structures in special flood hazard areas do not have flood insurance coverage, because the uninsured owners either are not aware that homeowner's insurance does not cover flood damage or do not perceive the serious flood risk to which they are exposed.

One area of flood insurance participation that should not be of concern, yet is, are those properties for which the purchase of flood insurance is mandatory. Flood insurance is required for properties located in flood-prone areas of participating communities for the life of mortgage loans made or held by federally regulated lending institutions, guaranteed by federal agencies, or purchased by government-sponsored enterprises.[8] No definitive data exist on the number of mortgages meeting these criteria; however, according to program officials, most mortgages made in the country meet the criteria, and for those in a special flood hazard area, the property owners would have to purchase and maintain flood insurance over the life of the loan.

The level of noncompliance with this mandatory purchase requirement is unknown. As we reported in June 2002,[9] federal banking regulators and government-sponsored enterprises believe noncompliance is very low on the basis of their bank examinations and compliance reviews. Conversely, flood insurance program officials view noncompliance with the mandatory purchase requirement to be significant, based on aggregate statistics and site-specific studies that indicate that noncompliance is occurring. Neither side, however, is able to substantiate its differing claim with statistically sound data that provide a nationwide perspective on noncompliance.

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[8]A government-sponsored enterprise is a privately owned, federally chartered corporation that serves a public purpose.

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

Data we collected and analyzed for our June 2002 report help address some concerns with the issue of noncompliance, but the issue remains unresolved. We analyzed available flood insurance, mortgage purchase, and flood zone data to determine whether noncompliance was a concern at the time of loan origination. Our analysis of mortgage and insurance data for 471 highly flood-prone areas in 17 states showed that, for most areas, more new insurance policies were purchased than mortgages issued, which suggests noncompliance was not a problem in those areas at the time of loan origination.

However, data to determine whether insurance is retained over the life of loans are unavailable, and this issue remains unresolved. There are indications that some level of noncompliance exists. For example, an August 2000 study by FEMA's Office of Inspector General examined noncompliance for 4,195 residences in coastal areas of 10 states and found that 416—10 percent—were required to have flood insurance but did not. Flood insurance program officials continue to be concerned with required insurance policy retention and are working with federal banking regulatory organizations and government-sponsored enterprises to identify actions that can be taken to better ensure borrowers are required to renew flood insurance policies annually.

The Administration and the Congress Have Proposed and Initiated Actions to Improve the Program

The administration and the Congress have recognized the challenges facing the flood insurance program and have proposed actions to improve it. These actions include the following:

- *Reducing or eliminating subsidies for certain properties.* In the fiscal year 2004 budget request, the administration proposed ending premium subsidies for second homes and vacation properties. According to flood insurance program officials, this change would affect 30 percent of the properties currently receiving subsidized premiums and would increase revenue to the program by $200 million annually. Additionally, program officials plan to increase the rates on all subsidized properties by about 2 percent in May 2003.
- *Changing premium rates for repetitive loss properties.* Two bills—H.R. 253 and H.R. 670—have been introduced to amend the National Flood Insurance Act of 1968 that

would, among other things, change the premiums for repetitive loss properties. Under these bills, premiums charged for such properties would reflect actuarially based rates if the property owner has refused a buyout, elevation, or other flood mitigation measure from the flood insurance program or FEMA.

- *Improving efforts to increase program participation.* The administration has identified three strategies it intends to use to increase the number of policies in force: expanded marketing, program simplification, and increasing lender compliance. With regard to lender compliance, the DHS plans to conduct an education effort with financial regulators about the mandatory flood insurance requirements for properties with mortgages from federally regulated lenders. Additionally, DHS plans to evaluate the program's incentive structure to attract more participation in the program.
- Conducting a remapping of the nation's flood zones. Many of the nation's FIRMs are old and outdated, and for some communities FIRMs have never been developed. The administration has initiated a multiyear, $1 billion effort to map all flood zones in the country and reduce the average age of FIRMs from 13 to 6 years.

While we have not fully analyzed these actions, on the basis of a preliminary assessment, they appear to address some of the challenges to the flood insurance program, including two of the key challenges—the program's financial losses and the perceived low level of participation in the program by property owners in flood-prone areas. Reducing subsidies and repetitive loss properties has the potential to help improve the program's financial condition, and increasing program participation would better protect those living in at-risk areas and potentially lower federal cost for disaster assistance after flood events. However, as mentioned earlier, actions such as increasing premiums to subsidized policyholders could cause some of these policyholders to cancel their flood insurance, resulting in lower participation rates and possibly raising federal disaster assistance costs.

The remapping of flood zones could potentially affect both participation rates and the program's financial condition. Remapping could identify additional properties in special flood hazard areas that do not participate in the program and for which DHS will need to undertake efforts to encourage their participation in the program. Further, these additional properties may not meet

the program's building standards since they were built before the FIRM that included properties in the special flood hazard area was developed. This could cause the program to offer subsidized insurance rates for these properties, potentially exacerbating the losses to the program resulting from subsidized properties. At the Subcommittee's request, we have begun a review to examine the remapping effort and its effects, and will report on the results later this year.

None of these proposals, however, addresses the need to move the program's current cash-based budgeting for presenting the program's financial condition to accrual-based budgeting. As we noted earlier, the current method of budgeting does not accurately portray the program's financial condition and does not allow the program to create reserves to cover catastrophic losses and be actuarially sound. If a catastrophic loss occurs, this may place the program in the position of again having to borrow substantial sums from the Treasury in order to satisfy all claims losses.

One additional challenge facing the flood insurance program relates to its placement in DHS. As we discussed in a January 2003 report on FEMA's major management challenges and program risks,[10] the placement in DHS of FEMA and programs such as flood insurance that have missions not directly related to security represents a significantly changed environment under which such programs will be conducted in the future. DHS is under tremendous pressure to succeed in its primary mission of securing the homeland, and the possibility exists that the flood insurance program may not receive adequate attention, visibility, and support as part of the department. For the flood insurance program to be fully successful, it will be important for DHS management to ensure that sufficient management capacity and accountability are provided to achieve the objectives of the program. In this regard, the President's fiscal year 2004 budget request notes that additional reforms to the flood insurance program are being deferred until the program is incorporated into DHS. This incorporation has now occurred, and congressional oversight—such as through hearings like this one today—should help to ensure that DHS maintains appropriate focus on managing and improving the flood insurance program and championing the reforms necessary to achieve the program's objectives.

[10]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Federal Emergency Management Agency*, GAO-03-113 (Washington, D.C.: January 2003).

Contacts and Acknowledgments

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